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MISCELLANEOUS TAX BILLS

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 612, H.R. 1808, H.R. 2597, H.R. 2647, H.R. 2981, H.R. 3191, H.R. 4444, H.R. 4473, H.R. 4577, H.R. 4592, H.R. 4990, H.R. 5630

MARCH 16, 1982

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MISCELLANEOUS TAX BILLS

TUESDAY, MARCH 16, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Select Revenue Measures,
Washington, D.C.

The subcommittee met at 10:16 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Fortney H. (Pete) Stark (chairman of the subcommittee) presiding.

Chairman Stark. The committee will come to order.

Today is the second hearing on miscellaneous tax bills held by the Subcommittee on Select Revenue Measures in this Congress. We will be taking testimony on 12 tax bills today, many of them sponsored by members of the Ways and Means Committee. These bills are generally technical in nature or provide special relief to narrow groups of taxpayers. The subcommittee serves as an important forum in which to publicly examine the merits of each bill.

The subcommittee will proceed in the usual manner, hearing first from the Treasury Department on all of the bills, and then taking each bill up generally in numerical order. However, we will try to accommodate the schedules of Members who have requested to testify on their bills. Witnesses should be prepared for possible interruptions.

I would also like to note that we will hear testimony on H.R. 3191 immediately after the Treasury Department since Mr. Guarini, the bill's sponsor and a member of this subcommittee, has a scheduling problem later in the day.

I would like to ask all the witnesses to cooperate with the Chair in our procedure, which requires them to summarize their testimony and limit their oral testimony to 5 minutes. Their full testimony will appear in the record and if any of the members of the subcommittee wish to engage in a discussion with the witnesses, they can elaborate more in their answers on parts of their testimony that may be important.

But given the number of bills before us today, I am going to have to strictly enforce the 5-minute rule and, without objection, the press release announcing today's hearings will be incorporated in the hearing record.

[The press release follows:]

[Press release of February 26, 1982]

HON. FORTNEY H. (PETE) STARK, CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS ANNOUNCES A PUBLIC HEARING ON MISCELLANEOUS TAX BILLS TO BE HELD TUESDAY, MARCH 16, 1982

The Honorable Fortney H. (Pete) Stark, (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announces a public hearing on miscellaneous tax bills to be held Tuesday, March 16, 1982. The hearing will begin at 10:00 a.m. in 1100 Longworth House Office Building, the Committee's main hearing room.

The lead-off witness at the hearing is expected to be the Honorable John E. Chapoton, Assistant Secretary for Tax Policy, Department of the Treasury.

Individuals and organizations interested in presenting testimony should note the Committee rules on pages two and three of this release.

Testimony is invited on the following minor bills:

1. *H.R. 612.*—(Mr. Rousselot)—To amend the Internal Revenue Code of 1954 to repeal the provisions requiring withholding of tax on certain gambling winnings.
2. *H.R. 1808.*—(Mr. Gephardt)—To amend the Internal Revenue Code of 1954 to allow certain transfers of imported beer from customs custody to a domestic brewery without payment of tax.
3. *H.R. 2597.*—(Mr. Jones of Oklahoma, Mr. Conable, Mr. Guarini, Mr. Hyde, Mr. Roemer, Mr. Bailey of Pennsylvania, Mr. Montgomery, Mr. Collins of Texas, Mr. Synar, Mr. Brinkley, Mr. Winn, Mr. McCurdy, Mr. Daniel B. Crane and Mr. Daub) To amend the Internal Revenue Code of 1954 with respect to the exemption from tax on veterans organizations.
4. *H.R. 2647.*—(Mr. Schulze)—To amend the Internal Revenue Code of 1954 to equalize the dollar amounts of income tax withholding on gambling winnings from horse racing, state-conducted lotteries, and certain other wagers.
5. *H.R. 2981.*—(Mr. Chappell, Mr. Wyden, Mr. Pepper, Mr. Benedict, Mrs. Holt, Mr. Zeferetti, and Mr. Horton)—To repeal section 3402(q) of the Internal Revenue Code of 1954 which requires for income tax purposes, amounts to be withheld from certain gambling winnings.
6. *H.R. 3191.*—(Mr. Guarini, Mr. Bafalis, Mr. Oberstar, Mr. Dwyer, Mr. Pepper, Mr. Won Pat, Mr. Gephardt, Mr. Matsui and Mr. Young of Alaska) To amend the Internal Revenue Code of 1954 to exempt conventions, etc., held on cruise ships documented under the laws of the United States from certain rules relating to foreign conventions.
7. *H.R. 4444.*—(Mr. Shannon)—To amend the Internal Revenue Code of 1954 with respect to the treatment of research or experimental expenditures for purposes of the small issue exemption from the industrial development bond rules.
8. *H.R. 4473.*—(Mr. Brodhead)—To amend the Internal Revenue Code of 1954 to permit the rollover to individual retirement plans of certain partial distributions received by employees.
9. *H.R. 4577.*—(Mr. Coehlo)—To amend Public Law 97-34.
10. *H.R. 4592.*—(Mr. Holland)—To amend the Internal Revenue Code of 1954 to eliminate the withholding requirements with respect to gambling winnings, to provide that information returns with respect to gambling winnings shall be required only in cases of payments of $10,000 or more, and to allow a three-year carryover of net gambling losses.
11. *H.R. 4990.*—(Mr. Vander Jagt and Mr. Guarini)—To amend the Internal Revenue Code of 1954 to clarify the status of certain amateur athletic organizations.
12. *H.R. 5630.*—(Mr. Pickle)—To make section 457(e)(1) of the Internal Revenue Code of 1954 inapplicable to certain State judicial plans.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony at the hearing should submit their requests to be heard by telephone to be followed by a formal written request, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515; telephone: (202) 225-3627. The initial telephone request must be received by the Committee not later than the close of business Friday, March 9, 1982. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

PROCEDURES TO BE FOLLOWED FOR SUBMITTING TESTIMONY

The following is an outline of the procedure to be followed by organizations and individuals who may either want to appear and testify during the hearing or file a written statement for the printed record of the proceedings. All requests to be heard should also contain the following information:

1. The name of the witness, title, address, firm affiliation and/or organization he will represent (as well as a telephone number where his or her designated representative may be reached).

2. If appearing in an individual capacity, a list of any clients at whose request or in whose employ the witness appears.

3. A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee should comply with the following rules:

1. All witnesses must submit 40 copies of their prepared statement to the full Committee office, Room 1102, Longworth House Office Building, not later than noon on Monday, March 15, 1982.

2. Witnesses should not read their written statements to the Subcommittee, but should instead limit their oral presentations to a summary of the points included in the statement.

3. Not more than five minutes will be allowed for the oral summary.

Failure to comply with these requirements may result in the witness being denied the opportunity to testify in person or being deferred until all other testimony is heard.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing five copies are required and must be submitted by the close of business, *Tuesday, March 30, 1982*, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office the day before the hearing.

Chairman STARK. I am happy to welcome this morning, representing the Treasury Department, the Honorable John E. Chapoton, Assistant Secretary for Tax Policy.

Buck, you may proceed as you wish.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman. I will attempt to make my summary of our statement as brief as possible.

Chairman STARK. I think technically you get 5 minutes for each bill.

Mr. CHAPOTON. We do have a number of bills before the subcommittee this morning. The first four, H.R. 612, 2647, 2981, and 4592, all relate to withholding on gambling winnings.

Since 1977, withholding at a 20-percent rate has been required in the case of certain gambling winnings. These include the receipt of $5,000 or more from a lottery conducted by a State agency acting under State law; receipts of $1,000 or more from a sweepstakes, wagering pool, or lottery other than a State lottery; and the receipt of $1,000 or more from a parimutuel pool with respect to horse racing or dog racing or jai alai, if the betting odds are at least 300 to 1. Keno winnings, slot machine winnings, and bingo winnings are exempt from withholding.

In addition to the requirement for withholding, information returns are required on IRS Form W-2G and they generally must be filed when the winnings from wagering activities exceed $600 and the payout is based on betting odds of 300 to 1 or higher.

Losses from wagering transactions are deductible only to the extent of gains from such transactions during the taxable year. Current law does not permit a carryover or a carryback of gambling losses.

H.R. 612 and 2981 would repeal withholding. H.R. 2647 would amend the withholding provisions by raising the threshold from $1,000 to $5,000. All three of these bills would leave intact the reporting requirements of existing law.

H.R. 4592 would repeal the withholding provisions of the current law and, in addition, would amend the current information reporting requirement so that reports would be required only when the amount of gambling winnings are $10,000 or greater. In addition, H.R. 4592 would allow taxpayers to carry a net wagering loss back 3 years and forward 3 years.

The Treasury is opposed to the efforts to repeal or limit significantly the provisions of current law imposing withholding and information reporting on gambling winnings. In addition, we oppose the carryover and carryback provisions of H.R. 4592.

The withholding provisions of current law do not apply to the overwhelming majority of payoff from wagering transactions. There is not only a dollar threshold requirement—generally $1,000—on the winnings, but also an odds limitation. That is, the betting odds generally must be at least 300 to 1. Thus, the withholding provisions are directed at those special types of wagers which represent unique and occasional windfalls.

These are the cases in which it is reasonable to expect the taxpayer to have significant net gambling winnings for the year and, as a result, a substantial income tax liability. We strongly believe that it is both necessary and appropriate to retain the withholding provisions in those instances.

Withholding is, we believe, an important tool available to the IRS to insure compliance in the reporting of income. There was a study of compliance in the reporting of gambling winnings, mandated by Congress in the Tax Reform Act of 1976, which covered the tax year 1977. That study concluded there was a strong correlation between rates of compliance and the presence of withholding at the source.

Taxpayers subject to withholding had consistently higher rates of compliance than those subject only to information reporting. Thus, from the viewpoint of tax administration, withholding provides a far better mechanism to insure compliance than does mere information reporting.

Withholding on significant gambling winnings automatically collects a portion of the tax liability attributable to those winnings. This helps reduce IRS audit and collection workloads. Withholding contributes to the efforts of the Internal Revenue Service to discourage the use of the so-called 10 percenters and similar practices used in some instances to avoid tracing of significant winnings. The withholding raises the cost to the bettor of using a 10 percenter, because, of course, the bettor cannot claim a refund for the taxes withheld in that instance.

Withholding is also superior to mere information reporting because information reporting requires both accurate information documents and a properly filed income tax return to achieve an acceptable match, as well as the resources to follow up where there are apparent discrepancies.

For these reasons, Mr. Chairman, we strongly oppose the provisions of these four bills and think that the current rules on withholding and reporting should remain intact.

H.R. 4990 clarifies the tax-exempt status of certain amateur sports organizations. The Treasury Department strongly supports clarifying legislation in this area. H.R. 4990 would accomplish this objective in a more direct manner than the companion provision in the Senate, S. 1757. However, there are several provisions in H.R. 4990 which we think need further consideration.

The Tax Reform Act of 1976 created under section 501(c)(3) as a separate category of tax exempt organizations, organizations organized and operated exclusively to foster national or international sports competition. In the development of this provision there was concern that such organizations could prove to be vehicles through which individuals paid for private recreational activities with tax deductible dollars.

Accordingly, the legislation permitted exemption only if no part of the organization's activities involved the provision of athletic facilities or equipment. The existence of this limitation has caused serious administrative problems. The IRS is compelled by the unambiguous language of the statute to conclude that organizations that provide facilities cannot be exempt unless they would otherwise qualify under section 501(c)(3).

As a complicating factor, a number of former components of the Amateur Athletic Union, the AAU, have been spun off and have applied for exemption under the amateur sports provision which was adopted in 1976. But since many of these organizations provide facilities and equipment, they could not qualify under the 1976 amendments. Further, it is not at all clear that they could have qualified under the standards of prior law—that is, the normal 501(c)(3) standards

IRS and Treasury have been unable to fashion an acceptable administrative approach which would draw a line between qualified and nonqualified organizations. We think only Congress can resolve this dilemma.

We do have numerous applications for exemption pending at the IRS, so we do think that corrective legislation is needed as soon as possible.

I should note that many may argue that the statutory restriction relating to facilities and equipment that was adopted in 1976 is unnecessary in light of the principle that no charitable contribution deduction is allowed when the donor receives a benefit by reason of the contribution—the so-called quid pro quo rule. While this doctrine should continue to apply in this as well as other areas, we believe that certain specific rules over and above the quid pro quo rule are necessary.

H.R. 4990 attacks this problem by focusing on the deduction and providing specific disallowance rules. The bill would eliminate the parenthetical statement in present law that denies exemption where facilities and equipment are provided. Instead, specific provisions will be added which would disallow deductions to the organization if the contribution is made by a person or by a member of his family who uses any athletic facility or equipment provided by an organization within a 12-month period before or after the date the contribution is made.

That is the general rule under H.R. 4990. Three exceptions are then provided. The first is a de minimis exception which provides that, for contributions of not more than $500, the disallowance would not apply. We think a de minimis exception is appropriate, but we think $500 might be a little too high. We would suggest that the figure be reduced to $200.

The second exception in H.R. 4990 is provided for contributions to the U.S. Olympic Committee or to a national governing body. We have no objection to this exception.

A third exception applies to nonreimbursed out-of-pocket expenditures made incident to the rendering of services by a noncompetitor. As detailed in our written statement, we are concerned that that exception needs further work because it might be subject to abuse, I do want to stress, however, that we do not want to limit the deductibility of expenses incurred by bona fide volunteers of amateur sports organizations. Our concern is, rather, with potential abuse cases where the service rendered is disproportionate in relation to the expenses claimed as a deduction.

So, in summary, on H.R. 4990, Mr. Chairman, we strongly support an effort to reach a legislative solution to the problems caused by the 1976 act and the parenthetical statement in that legislation.

H.R. 4473 would amend the Internal Revenue Code to allow many partial distributions from pension, profitsharing, stock bonus, and annuity plans to be rolled over to individual retirements accounts [IRA's] without the payment of a current tax.

Under current law, a distribution from a qualified plan that meets the technical requirements of a lump sum distribution is entitled to various forms of special treatment, including eligibility for capital gains treatment or, in some cases, special income averaging. Taxpayers receiving lump sum distributions from qualified plans may instead avoid current tax by rolling over the distribution into an IRA or another tax-qualified plan. In that instance, tax is payable only as distributions are made from the IRA or plan into which the funds are rolled.

None of the special forms of tax treatment available to lump sum distributions is applicable to an IRA distribution. Thus, rollovers to IRA's enable a recipient to avoid current tax only if the recipient foregoes favorable forms of tax treatment and retains the plan distribution until retirement years.

A distribution from a qualified plan that does not constitute a lump sum distribution cannot be rolled over into an IRA or another qualified plan and does not qualify for any of the forms of special tax relief available for the so-called lump sum distributions. However, in 1980 Congress extended tax-free rollover treatment to an employee who receives a partial distribution from a money purchase pension plan, even though the employee continues to have an interest in a defined benefit pension plan.

We suggest that in light of the substantial retirement plan policies which are served by rollovers, the rollover rules should be still further liberalized. H.R. 4473 is a step in this direction. However, as provided under H.R. 4473, an employee who rolls over such a distribution should not be eligible for 10-year forward averaging, capital gains treatment or exclusion of net unrealized appreciation on employer securities attributable to employer contributions with respect to any further distributions from the plan or any other plan that would be aggregated with it under the lump sum distribution rules.

In other words, the rollover provisions ought to be the sole relief. That is what 4473 provides, and we agree with that concept. I do state in our written statement that we cannot support the bill until we have a better feel of what the revenue impact is. But, Mr. Chairman, we are attempting to get a better fix on that and our preliminary indication is that the adverse revenue impact should not be significant. In that case we would support the bill.

Turning now to H.R. 3191, relating to cruise ship deductions, the restrictions were first placed on the deductibility of expenses related to foreign conventions in 1976. At that time Congress recognized the growing practice among professional, business, and trade organizations to sponsor cruises, trips and conventions during which only a small portion of time was devoted to business activities.

The first shot at the problem by Congress was to say that deductions could be claimed for only two conventions per year if the primary purpose for the trips was business and not pleasure.

Then Congress came back and substituted, in 1980, a reasonableness test. Under the reasonableness test, the expenses of attending a foreign convention or seminar or similar meeting, those expenses are not deductible unless it is more reasonable to hold the conference outside of North America than within it. A convention held on any cruise ship is not considered as satisfying the reasonableness test, and thus no deduction is allowed in connection with cruise ship-type conventions.

H.R. 3191 would modify this rule and permit deduction of attending a convention, seminar, or similar meeting held on a domestic cruise ship if all ports of call of such cruise are inside the North American area. A domestic cruise ship is defined to mean any cruise ship documented under laws of the United States.

Mr. Chairman, we are opposed to H.R. 3191. The reasonableness test adopted in 1980 was intended to deal with the primary problem of foreign conventions where the selection of the foreign site is made because of vacation motives rather than primary business considerations. Even though a convention benefits the taxpayer's business to some degree, there is no justification for a tax deduction where a convention is held at a foreign site having nothing to do with the taxpayer's business. In such cases, personal benefit predominates.

We think that reasoning is sound and applies particularly to conventions held aboard cruise ships. The only reason for holding a convention or seminar on a cruise ship would be for personal enjoyment. It would be a rare case where a cruise would have any connection with the topic of the convention or with the organization involved.

In short, we think allowing a deduction for expenses of attending a convention aboard a cruise ship would too closely resemble a tax-subsidized vacation. It is that type of deduction which discredits our entire tax system.

H.R. 4444 relates to capital expenditures limitations on small issue industrial development bonds. Under present law, interest on IDB's is not exempt from Federal income tax since the bond proceeds are used in a private trade or business. But there are exceptions for so-called exempt activities and for certain small issue IDBs.

The small issue IDB rules apply when the amount of the issue is $1 million or less and the bond proceeds are used for land or depreciable property and, in certain instances, the $1 million cap may be increased to $10 million, provided that all outstanding exempt small issues plus other capital expenditures with respect to the project that are made within a 6-year period—3 years before and 3 years after—the date of the bond issue in question are aggregated for purposes of the limitation. It basically means that the capital expenditures with respect to this project cannot exceed $10 million.

Under Treasury regulations, the capital expenditures for making this $10 million determination are determined under the usual tax rules for distinguishing between capital charges on the one hand, and expenses which are currently deductible on the other. Thus, research and development costs of developing a new formula, for example, are capital in nature and would count under the present rules against the $10 million cap.

H.R. 4444 would alter this result. It would provide that R. & D. expenses which the project user elected to deduct currently under section 174 would not be counted as capital for IDB purposes. Even though R. & D. generally is capital in nature, we believe that this proposal to treat R. & D. as noncapital for IDB purposes has some merit. The interaction of the R. & D. rules and the section 103 small issue requirements could, in some cases, have the effect of creating an inequitable bias against R. & D.-intensive firms desiring to make use of the small issue exemption.

We must recognize that we are not writing on a clean slate in this area. Substantial tax incentives for R. & D. were enacted as part of the 1981 act. We must also consider the appropriateness of a piecemeal change to the tax rules governing IDB's, which is an area fraught with numerous and very basic unresolved questions.

A comprehensive reexamination of this area is clearly in order. We are therefore of the view that it is inappropriate to make this change in the absence of a complete review of the basic issues presented by section 103. I might add that we have made a proposal in this area which will present the opportunity for a review of this rule along with the other rules applicable to exempt small issue industrial development bonds.

H.R. 2597 relates to the membership requirements for veterans organizations. Since 1969 code section 501(c)(19) has granted tax exempt status to certain groups of veterans. In order to qualify for such status, the group must be composed of at least 75-percent war veterans. The remaining 25 percent must be substantially composed of veterans other than war veterans, veterans' widows or widowers, and military cadets.

The problems faced by these organizations, simply stated, Mr. Chairman, is that as a result of a prolonged period of peace and the natural attrition rate among surviving war veterans, the percentage of war veterans in section 501(c)(19) organizations is reducing. H.R. 2597 would amend the membership test to provide tax exemption for an otherwise-qualifying organization, provided that at least 75 percent of its members are past or present members of the U.S. Armed Forces, without regard to whether they have served during a period of war.

Mr. Chairman, we are sympathetic to retention of the tax exemption for 501(c)(19) organizations, but we are concerned about the ability of these organizations to sell insurance and not be subjected to the unrelated business income rules with respect to insurance, and therefore we must oppose a change which would allow significant expansion of the membership of these organizations, given this rule that they are not subject to the unrelated business income rules on their insurance sales.

We are dealing now and have under thorough study in the Treasury Department the taxation of life insurance in general, both at the policyholder level and and at the company level and any extension of the total nontaxation of insurance would give us a great deal of concern.

H.R. 4577 deals with the transfers of restricted stock. Prior to the 1981 act, any taxpayer who received stock subject to section 16(b) of the SEC Act of 1934 was required to treat the value of this stock as compensation when received, even though he could not then dispose of the stock because of the 16(b) restriction. If the value of the stock had declined between the time the stock was received and it was sold, code section 83, prior to the 1981 Tax Act, would have required the higher value to be picked up in taxable income.

In 1981 that code section was changed to state that for years after December 31, 1981, the value to be included in the employee's taxable income and deducted by the employer would be the value at the end of the 16(b) period. That code section also preserves symmetry in the timing of the deduction to the employer and the income picked up by the employee.

We supported that change as part of the 1981 act. H.R. 4577 would make this change in the restricted stock transfer retroactive to June 30, 1969, on an elective basis. We must oppose this as we oppose any retroactive application of changes in the tax law.

There are additional reasons why retroactivity, we think, would not be appropriate in this case. First, by going back to 1969, the bill would permit taxpayers to elect to open years closed by the statute of limitations. The purpose of the statute of limitations is to prevent both the IRS and taxpayers from reopening issues after a certain period of time regardless of how meritorious the position may be.

Second, the bill does not simply apply the new rule to past years. It provides on an elective basis the option of applying either the old or the new rules. Such an elective rule against the Government and for the taxpayer in each instance does not, we think, represent a sound tax policy and thus we must oppose H.R. 4577.

H.R. 5630 relates to State judicial retirement plans. Section 457 was added to the code by the Revenue Act of 1978. It generally permits employees of a State or local government to defer compensation under an eligible State deferred compensation plan if the deferral does not exceed $7,500 or 25 percent of compensation. Amounts deferred are includible in income of the participant or his beneficiary only when paid or made available under the plan.

If the plan fails to meet the requirements of an eligible plan, as specified in section 457, section 457(e)(1) provides that all the compensation deferred after February 1, 1982, will be includible in income in the first year in which there is no substantial risk of forfeiture.

The statutory list of exceptions does not include certain regular but unfunded State retirement plans, that is, plans that provide benefits solely by periodic appropriations by the State legislature from the State's general fund.

As we review section 457, it is clear to us that the unfunded regular retirement plan of a State was not intended to be disqualified by this restriction of 457(e)(1), but given the clear and unambiguous language of the statute, we have been unable to draft a regulatory exception which would accommodate certain unfunded State retirement plans.

H.R. 5630 provides statutory clarification of the unfunded statement retirement plan issue only for certain plans covering State judges. We think this bill does go in the right direction and therefore we support H.R. 5630, but we would also recommend that Congress make a further attempt to exempt from section 457 other State unfunded retirement arrangements which are not judicial plans but which are unfairly disadvantaged by section 457(e).

So we do support H.R. 5630 and we would suggest that is scope be broadened.

Finally, Mr. Chairman, H.R. 1808 deals with the excise tax rules for imported beer. Domestically produced beer is subject to $9 a barrel excise tax at the time the beer is removed from the brewery for consumption or sale. Imported beer is subject to $9 per barrel tax at the time the beer is removed from Customs' custody, even if the beer is then transferred to a domestic brewery.

H.R. 1808 would change the point of imposition of the excise tax on imported beer from the point of removal from Customs to the point of sale from the brewery in the case of any beer brought into the United States in bulk containers. Because bulk beer can be stored indefinitely and transferred tax free between producers and bonded warehouses, this bill could provide a lengthy deferral of excise tax liability for all beer imported in these containers.

The bill would thus place these few importers with the capability of importing container beer at a competitive advantage relative to those importers that will continue to be liable for excise taxes at the point of removal from Customs' custody. We think that is not appropriate and, therefore, we must oppose H.R. 1080.

That concludes a summary of our position.

[The prepared statement follows:]

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present the views of the Treasury Department on the following bills: H.R. 612, 2647, 2981, and 4592, relating to gambling winnings; H.R. 4990, relating to the tax-exempt status of certain amateur athletic organizations; H.R. 4473, relating to rollovers of partial distributions from qualified plans and tax-sheltered annuities to individual retirement accounts; H.R. 3191, relating to the deductibility of expenses of attending conventions on domestic cruise ships; H.R. 4444, relating to the exclusion of research expenses from the capital expenditure limitation for small issue industrial development bonds; H.R. 2597, relating to membership requirements for tax-exempt veterans organizations; H.R. 4577, relating to the effective date for the restricted property provision of the Economic Recovery Tax Act of 1981; H.R. 5630, relating to deferred compensation plans for State judges; and H.R. 1808, relating to transfers of certain imported beer from customs custody to a domestic brewery.

After setting out a summary and the position of the Treasury with respect to these bills, I will discuss the proposals in detail:

Summary

H.R. 612, H.R. 2981, and H.R. 4592 would repeal the requirement for withholding as it applies to gambling winnings and H.R. 2647 would raise the dollar threshold at which withholding begins. H.R. 4592 would also substantially limit the instances in which information reporting on gambling winnings is required and would allow taxpayers to carry a net wagering loss back 3 years and forward 3 years.

Treasury is strongly opposed to any efforts to repeal, or limit significantly, the provisions of current law imposing withholding and information reporting or gambling winnings. In addition, Treasury opposes that provision of H.R. 4592 which would allow a 3-year carryback and carryforward for net gambling losses.

H.R. 4990 would provide that organizations which foster national or international amateur sports competition are entitled to tax-exempt status without regard to their provision of facilities or equipment. Additionally, special limitations on the deductibility of contributions to such organizations are provided.

Treasury strongly supports legislation to clarify this area. However, certain issues remain under H.R. 4990. We would be pleased to assist in fashioning a solution which would balance the interests of all concerned.

H.R. 4473 would allow certain partial distributions from qualified pension, profit-sharing, stock bonus, and annuity plans to be "rolled over" to individual retirement accounts without the payment of current tax. Treasury supports the concept of H.R. 4473. These changes would promote private saving for retirement and would simplify one of the most complex areas of the tax law. Treasury is concerned, however, that the bill may have a negative impact on revenue in the short term and we therefore cannot support this bill at this time.

H.R. 3191 would allow a deduction for business expenses for attending a convention, seminar, or similar meeting aboard a domestic cruise ship to the same extent as other business expenses if all ports of call of the cruise are within the North America area. Treasury is strongly opposed to H.R. 3191.

H.R. 4444 would provide that R&D expenses which the taxpayer elects to deduct under section 174 will not be treated as capital expenditures for purposes of the $10 million limitation on small issue industrial development bonds. Treasury believes that it is inappropriate to make the change effected by this bill without a complete review of the basic issues presented by section 103.

H.R. 2597 would broaden the membership requirements for tax-exempt veterans organizations, to apply the 75 percent veteran membership requirement without regard to whether such service was in war or peace. Treasury opposes H.R. 2597.

H.R. 4577 would make retroactive to 1969 section 252 of the Economic Recovery Tax Act, which permits a taxpayer who receives stock subject to certain Federal securities or accounting law restrictions to include the value of the stock in income when those restrictions terminate. Treasury opposes H.R. 4577.

H.R. 5630 would exempt certain State judicial retirement plans from the disqualification rules of section 457(e)(1). Treasury supports H.R. 5630.

H.R. 1808 would permit certain imported beer to be transferred tax-free from customs custody to a domestic brewery. Treasury opposes H.R. 1808.

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H.R. 612, H.R. 2647, H.R. 2981, and H.R. 4592

Repeal, or Substantial Modification, of the Requirements for Withholding and Information Reporting in the Case of Certain Gambling Winnings

Current law provides for information reporting and withholding in the case of the payment of certain gambling winnings. Three of these bills would repeal the requirement for withholding as it applies to gambling winnings. One of these three bills, H.R. 4592, would substantially limit the instances in which information reports are required. This bill would also allow taxpayers to carry net wagering losses back 3 years and forward 3 years. The fourth bill, H.R. 2647, although not repealing withholding, would raise the dollar threshold at which withholding begins.

Present Law

Since 1977, withholding, at a 20 percent rate, has been required in the case of certain gambling winnings. Net proceeds from the following categories of gambling winnings are subject to withholding:

1. Proceeds of more than $5,000 from a lottery conducted by a State agency acting under State law.
2. Proceeds of more than $1,000 from a sweepstakes, wagering pool or lottery, other than a State lottery.

3. Proceeds of more than $1,000 from a parimutuel pool with respect to horse or dog racing, or jai alai, if the betting odds are at least 300 to 1.

4. Proceeds of more than $1,000 from any other wagering transactions if the betting odds are at least 300 to 1.

Winnings from keno, slot machines, and bingo are exempt from the current law provisions for withholding.

In addition to the requirement for withholding, information returns (Forms W-2G) generally must be filed when the winnings from wagering activities exceed $600 and the payout is based on betting odds of 300 to 1, or higher. Although the $600 threshold is provided for by statute, the 300 to 1 odds requirement is a product of longstanding administrative practice. In the case of winnings from bingo or slot machine play, the dollar threshold is set at $1,200 and, in the case of keno, it is set at $1,500. In neither of these cases is there an "odds requirement." When an information return is required, the person receiving the payment must furnish the payor with his name, address, and taxpayer identification number. This information, in turn, must be reported to the Internal Revenue Service.

Under current law, losses from wagering transactions are deductible only to the extent of gains from such transactions in the taxable year. Current law does not permit the carryover of such losses to a later or earlier taxable year.

Proposed Legislation

H.R. 612 and H.R. 2981 are identical bills. Both would repeal the provisions of current law relating to withholding on gambling winnings. They would leave the information reporting requirements intact. The provisions of H.R. 612 and H.R. 2981 would be effective for payments made after date of enactment.

H.R. 2647 would amend the withholding provisions of current law by raising the dollar threshold from $1,000 to $5,000. The betting odds requirement at 300 to 1 would be retained. H.R. 2647 would not modify the information reporting requirements of current law and would be effective for payments made after date of enactment.

H.R. 4592 would repeal the withholding provisions of current law. In addition, it would amend the current information reporting requirement so that reports would be required only where the amount of gambling winnings was $10,000, or greater. In addition to these changes, H.R. 4592 would allow taxpayers to carry a net wagering loss back 3 years and forward 3 years.

Treasury Position

Treasury is strongly opposed to any efforts to repeal, or limit significantly, the provisions of current law imposing withholding and information reporting on gambling winnings. In addition, Treasury opposes that provision of H.R. 4592 which would allow a 3-year carryback and carryforward for net gambling losses.

At the outset, it should be noted that the withholding provisions of current law do not apply to the overwhelming majority of payoffs from wagering transactions. There is not only a dollar threshold requirement (generally $1,000) but also an odds limitation, i.e., the betting odds generally must be at least 300 to 1. Thus, the withholding provisions are directed at those special types of wagers which represent unique and occasional windfalls. These are the cases in which it is reasonable to expect a taxpayer to have significant net gambling winnings for the year and, as a result, a substantial income tax liability. We strongly believe that it is both necessary and appropriate to retain the withholding provisions in those instances.

Secondly, it must be recognized that withholding is an important tool available to the Internal Revenue Service to insure compliance in the reporting of income. Withholding is an element in improving compliance in two respects. First, it provides an incentive for taxpayers who have substantial winnings to report those winnings accurately in order to claim the benefit of the withheld amounts on their income tax returns. Second, withholding provides a means of collecting at least a portion of the tax due from winners who fail to file income tax returns. An Internal Revenue Service study of compliance in the reporting of gambling winnings, mandated by the Tax Reform Act of 1976, concluded that there was a strong correlation between rates of compliance and the presence of withholding at the source. Taxpayers subject to withholding had consistently higher rates of compliance than those subject only to information reporting.

Third, from the viewpoint of tax administration, withholding provides a far better mechanism to ensure compliance than does mere information reporting. Withholding on significant gambling winnings automatically collects a portion of the tax liability attributable to those winnings. This helps to reduce the tax agency's audit and collection workloads. Withholding contributes to the efforts by the Internal Revenue Service to discourage the use of so-called "10 percenters," and similar practices to avoid tracing of significant winnings. Withholding raises the cost to the bettor of using a "10 percenter" because the bettor cannot claim a refund for the taxes withheld. Withholding is also superior to mere information reporting because information reporting requires both accurate information documents and a properly filed income tax return to achieve an acceptable "match," as well as the resources to follow up where there are apparent discrepancies. In the absence of withholding, neither the payor nor the payee has any real incentive to verify the accuracy of the statements made on the information return. Inaccuracies, whether intentional or inadvertent, frustrate the ability to match the documents, and raise the overall cost of tracing gambling winnings to the returns. While information reporting is an effective tool to increase compliance, its combination with a system of withholding is a significant benefit from the standpoint of tax administration.

Finally, some in the industry have argued that the imposition of withholding and information reporting creates an incentive for patrons to wager with illegal bookmakers rather than with legalized and state-regulated wagering establishments. Proponents of this view argue that withholding and information reporting cause the gambling dollars of these bettors to flow to the criminal elements that operate the illegal wagering activity. Furthermore, they argue that legalized establishments whose income is a function of the gross amount wagered are financially disadvantaged by this decrease in the amount wagered.

In our view, this argument proves too much. On careful analysis, one must ask the question why such bettors prefer to place their bets with illegal bookmakers. One natural conclusion is that some, if not a substantial portion, of these bettors must be attempting to avoid the reporting and withholding requirements of current law. It is also logical to assume that these individuals are failing to report this income on their returns. Reduced to its essential points, this argument asks us to condone implicitly a failure to report income by making it easier to win at legalized establishments and not report the winnings. This also provides a net economic benefit to the legalized establishments by allowing them to profit from the winnings which will go unreported. Treasury simply cannot stand by and acquiesce in a change which will encourage, rather than discourage, the failure to report income accurately.

For the reasons set forth above, Treasury strongly opposes the provisions of these four bills which would eliminate, or significantly modify, the information reporting and withholding requirements of current law.

H.R. 4990 -- Amateur Sports Organizations

H.R. 4990 clarifies the tax-exempt status of certain amateur sports organizations. S. 1757, a bill similar in concept but taking a somewhat different approach, has been introduced in the Senate. The Treasury testified on S. 1757 on December 11, 1981.

The Treasury Department strongly supports clarifying legislation in this area. While both H.R. 4990 and S. 1757 would provide this clarification, from a technical standpoint H.R. 4990 would accomplish the objectives in a more direct manner, although there are still several provisions in H.R. 4990 which need further consideration and which we will address. We would be pleased to assist in fashioning a solution to these issues which would effectively balance the interests of all concerned.

To put the issues in perspective, I believe that some background may be useful. Prior to 1976, organizations which were engaged in the teaching of sports or promoting sports for youth generally qualified for tax exemption as educational or charitable organizations under section 501(c)(3) of the Internal Revenue Code and were thereby eligible recipients of tax deductible contributions. However, organizations which were engaged in promoting, governing, and regulating amateur sports but not for youth were generally exempt under section 501(c)(4) or 501(c)(6), with the result that contributions to such organizations were generally not eligible for tax deduction.

The Tax Reform Act of 1976 sought to provide clarification and uniformity in this area. Additionally, Congress considered it appropriate to encourage organizations which contributed to developing athletes for competition in the Olympic games and other national or international competition. Accordingly, section 1313 of the Act created, as a separate category of exempt organization under section 501(c)(3), organizations organized and operated exclusively to foster national or international amateur sports competition. The provision was intended not to affect adversely the qualification of any organization which would qualify under the standards of prior law.

In the development of this provision there was substantial concern that organizations which foster amateur sports could prove to be vehicles through which individuals paid for private recreational activities with tax-deductible dollars. Accordingly, the Conference Committee added as a condition to exemption the parenthetical phrase "(but only if no part of [the organization's] activities involve the provision of athletic facilities or equipment)." Although the legislative history of the 1976 Act indicates that the purpose of this limitation was to prevent qualification for organizations which, like social clubs, provide facilities or equipment to their members, the statute is absolute, stating that any provision of facilities bars exemption. Thus, the effect of the clear provisions of the statute is to prevent exemption, not only for social clubs, but also for other amateur sports organizations.

The existence of this facilities-equipment limitation has created serious administrative problems. Compelled to follow the unambiguous language of the statute, the Internal Revenue Service and Treasury have determined that organizations providing facilities cannot be recognized as exempt, unless the organization could otherwise qualify under section 501(c)(3). As a complicating factor, the Congress in 1978 enacted the Amateur Sports Act, a purpose of which was to coordinate and reorganize amateur sports in this country. The Act requires that the national governing bodies for Olympic sports be incorporated as separate autonomous entities. As a result, a number of former components of the Amateur Athletic Union (AAU) have been spun off and have applied for exemption under the amateur sports provisions. However, as many of these organizations provide facilities and equipment, they could not qualify under the 1976 Act amendments. Further, it was not at all clear that they could qualify under the standards of prior law. This created the ironic situation where, while the AAU was an exempt section 501(c)(3) organization when the 1976 amendments were enacted, the national governing bodies might not qualify for exemption under present law.

The Service and Treasury have been reluctant to take the draconian measure of issuing adverse rulings to organizations providing facilities and equipment. At the same time, however, we have been unable to fashion an approach administratively which would appropriately draw the lines between qualified and nonqualified organizations. Only Congress can provide the solution to this dilemma. In the meantime, numerous applications for exemption are pending at the IRS and Treasury awaiting a solution.

We therefore appreciate the introduction of legislation to solve this problem. As I stated earlier, from a technical standpoint, H.R. 4990 solves the problem in a more direct fashion than does S. 1757. The Senate bill makes certain changes to the exemption section, section 501(c)(3), which defines a qualified organization. The goal of these provisions, of course, is to differentiate organizations which truly foster national or international amateur sports competition from those which are merely for private recreation. This line, however, is a difficult, if not impossible, one to draw. Further, we do not believe it necesssary to make the attempt in the exemption provisions. As we see it, the problem is not one of exemption *per se* but rather the deductibility of the contributions to the organization. We do not anticipate that these organizations will have substantial income. However, we are concerned that individuals will be able to pay for recreational activities with tax-deductible contributions.

In this connection, I should note that some may argue that legislative changes are unnecessary in light of the principle that no charitable contribution deduction is allowed where the donor receives a benefit by reason of the contribution. While this *quid pro quo* doctrine is an important and long-standing principle of law, its reaches are uncertain and it is not easy to apply. While the *quid pro quo* doctrine should continue to apply in this, as well as in other, areas, we believe that certain specific rules, over and above *quid pro quo*, are necessary.

Thus, H.R. 4990 attacks the problem by focusing on the deduction rather than the exemption sections and by providing specific disallowance rules. Under that bill, the parenthetical to section 501(c)(3) would be eliminated, with the result that any otherwise eligible organization which fosters national or international amateur sports competition will be eligible for exemption without regard to its provision of athletic facilities or equipment. However, specific provisions would be added to the income, estate, and gift tax charitable contribution sections which will preclude deduction for contributions to these organizations under certain circumstances. As a general matter, the provision would disallow a deduction to the organization if the contribution is made by a person (or by a member of his or her family) who uses any athletic facility or equipment provided by the organization within a period beginning 12 months before and ending 12 months after the day the contribution is made.

The changes to the section 501(c)(3) rules would be retroactive to the effective date of the 1976 Act. The changes to the contribution rules would apply prospectively to contributions made after December 31, 1981. Thus, contributions made to these organizations in prior years would be allowed without regard to the specific disallowance rules.

H.R. 4990 provides three exceptions to the disallowance rule. The first, intended as a de minimis rule, provides that contributions up to $500 per year will be insulated from the specific disallowance provision. This exception highlights one of the problems in this area. We recognize that there will be cases where a person makes a very small contribution to an organization and he (or a member of his family) makes considerable use of the facilities. In this case, probably no deduction should be allowed. At the other extreme are cases where the donor makes a substantial contribution and uses the facilities to a relatively insignificant extent. In these cases, at least some portion of the contribution should be allowed as a deduction. In between are the vast majority of cases where there is some contribution and some use of facilities. In these cases, it is very difficult to determine the amount, if any, of the contribution which should be allowed. Compounding the problem are the administrative difficulties of measuring, under any of these scenarios, the extent and value of the use, and the limited audit resources of the Internal Revenue Service to make this measurement. While the quid pro quo doctrine is available to handle some of the clearer cases when selected for audit, we believe that a rule is necessary to facilitate administration in other instances.

The approach taken by H.R. 4990 is to provide a strict disallowance rule, barring all deduction when there is use of the facilities, and then providing the de minimis exception. We believe there is considerable merit to this approach. The strict disallowance rule will eliminate the requirement that the Service monitor in every case the extent and value of use, and the de minimis exception carves out those cases where the amounts are small and therefore not of substantial concern. In this connection, however, we think the $500 exception may be too high. Inasmuch as the purpose of the disallowance rule in the first instance is to police the financing of private recreation with deductible contributions, the exception should be limited to relatively small amounts. We would recommend a $200 de minimis exception. Further, I must emphasize that if a de minimis exception is provided (whatever the amount), it should not in any way affect the quid pro quo principle. Thus, even contributions within the de minimis limit would be subject to disallowance if the link between the contribution and benefit to the contributor could be established.

A second exception to the specific allowance rule (also subject to quid pro quo) applies to contributions to the U.S. Olympic Committee or to a national governing body. We have no objection to this exception since contributions to these types of organizations were generally allowed under the law prior to 1976 without regard to the provision of facilities or equipment to the contributor or the contributor's family. We agree that a similar rule should now apply.

The third exception applies to non-reimbursed, out-of-pocket expenditures made incident to the rendering of services by a noncompetitor. We are troubled by this provision in that it may be subject to abuse. For example, a parent wanting to watch his or her child participate in an out-of-town athletic competition may arrange to render some nominal service to the sponsoring organization and thereby claim a deduction for the travel and lodging expenses incurred. While this abuse potential is not unique to amateur sports organizations, its impact becomes more acute given the nature of the organization involved and the likelihood of family members incurring the expenses described.

We believe, and we think supporters of the bill would agree, that charitable contribution deductions should not be allowed under these circumstances. Further, we believe that under current law such deductions would not be allowed. Under existing authority, if an out-of-pocket expenditure is made primarily for the personal benefit of the contributor, it is not a deductible contribution. Similarly, with respect to expenses which have a dual character (in that they benefit both the charity and the taxpayer), which are incurred incident to the rendering of services, the presence of a substantial direct personal benefit to the taxpayer or someone other than the charity is fatal to the claim for a charitable contribution. In this area also the legislative history should confirm that the exception is subject to this rule of existing law.

In this connection, I must add that we do not want to limit the deductibility of expenses incurred by the bona fide volunteers of amateur sports organizations. We understand that many organizations depend upon these volunteers as their life blood and we do not want to interfere with that relationship. Our concern is rather with the abusive cases where the service rendered is disproportionate in relation to the expenses claimed.

We strongly support an effort to reach a legislative solution to the problems raised in this area. Accordingly, we would be pleased to assist in fashioning a measure that is satisfactory for all concerned.

H.R. 4473 -- Rollover of Partial Distributions

H.R. 4473 would amend the Internal Revenue Code to allow many partial distributions from pension, profit-sharing, stock bonus, and annuity plans to be "rolled over" to individual retirement arrangements (IRA's) without the payment of current tax.

We support the concept of H.R. 4473. These changes would promote private saving for retirement and simplify one of the most complex areas of the tax law. Treasury is concerned, however, that this bill may have a negative short-term revenue impact and we therefore cannot support this bill at this time.

Under current law a distribution from a qualified plan that meets the technical requirements of a lump sum distribution is entitled to various forms of special tax relief. First, part of the distribution may be eligible for capital gains treatment. Second, if employer securities attributable to employer contributions are included in the distribution, any increase in the value of the securities since their acquisition by the plan is not subject to tax until the securities are sold.

The most recent form of special tax relief for lump sum distributions was provided by the Employee Retirement Income Security Act of 1974 (ERISA) which amended the Code to allow special 10-year forward income averaging. Roughly, this treats the distribution as if it were received ratably over a 10-year period and was the only income earned in each such year. The ostensible purpose of such relief was to mitigate the impact of a progressive tax on individuals who receive extraordinary amounts of income in one year and perhaps to recognize the general applicability of lower marginal rates after retirement.

Since the 10-year forward averaging provision seems to assume that the taxpayer would have little or no additional income in his post retirement years, it is appropriate that a taxpayer who elects this special tax relief not be entitled to additional retirement benefits. Hence, in order to qualify as a lump sum distribution, the distribution must constitute, among other things, a distribution of the total balance to the credit of the employee in all similar tax-qualified plans.

The same requirement of a distribution of the total balance to the credit of the employee applies to tax-free rollovers of distributions from qualified plans. Under the rollover rules, taxpayers receiving lump sum distributions from qualified plans can avoid current tax by "rolling over" the distribution into an IRA or another tax-qualified plan. Tax is payable only as distributions are made from the IRA or other plan.

None of the special forms of tax treatment available to lump sum distributions is applicable to an IRA distribution. Rollovers to IRA's therefore enable a recipient to avoid current tax only if the recipient forgoes favorable forms of tax treatment and retains the plan distribution until retirement years.

A distribution from a qualified plan that does not constitute a lump sum distribution is taxed very differently under current law. Partial distributions are includible in income in the year in which received. They cannot be rolled over to an IRA or to another qualified plan, and they do not qualify for any of the forms of special tax relief available for so-called lump sum distributions. However, a subsequent distribution from the same plan may qualify as a lump sum distribution. That second distribution can then be rolled over and may be eligible for special tax relief.

The current tax treatment of partial distributions is harsh when a substantial partial distribution is received. It can also act as a tax trap for the unwary. This can occur if, for example, the employee terminates employment before full vesting, receives a distribution of the vested balance to his credit, and is reemployed before the nonvested balance to this credit is forfeited. In this case, current law requires that the first distribution be treated as ineligible for special tax treatment and for IRA rollovers. Thus, if the employee has already made an IRA rollover, the employee will be subject to tax penalties on his "excess contribution."

Expanded rollover treatment for plan distributions will eliminate or reduce the problems I have described. This expansion would continue the recent trend of liberalizing the rollover rules. In 1974, when rollovers were introduced, only complete rollovers of all proceeds of lump sum distributions were permitted. However, we have since realized that rollovers which are consistent with the policy of encouraging individuals to save for retirement and to have assets available for their retirement period need not be tied to "lump sum distributions."

Since 1974, the rollover rules have been liberalized to permit partial rollovers, rollovers of proceeds from the sale of property, rollovers of section 403(b) annuities and custodial accounts, rollovers of lump sum distributions received by a spouse upon the death of a participant, rollovers of total distributions that did not meet certain technical lump sum distribution rules, and rollovers of distributions received due to a plan distribution or a sale of a subsidiary or assets.

In 1980, Congress first extended tax-free rollover treatment to one type of partial distribution. An employee who received a distribution from a money purchase pension was allowed to treat the distribution as eligible for rollover even though the employee continued to have an interest in a defined benefit pension plan. However, the employee then lost the benefit of special tax treatment for later distributions from either plan.

We suggest that in light of the substantial retirement plan policies which are served by rollovers, the rollover rules should be still further liberalized. H.R. 4473 is a step in this direction, but additional action is needed. For example, rollover treatment should also be extended to partial distributions received after a plan termination or discontinuation of plan contributions; and to distributions received due to sale of a corporate subsidiary or assets. Rollovers of lump sum distributions are permitted in these circumstances and there is no reason to exclude partial rollovers. However, as provided under H.R. 4473, an employee who rolls over such a distribution should not be eligible for 10-year forward averaging, capital gains treatment, or exclusion of net unrealized appreciation on employer securities attributable to employer contributions with respect to any further distributions from the plan or any other plan that would be aggregated with it under the lump sum distribution rules.

We agree that rollover treatment should not be extended to payments under a life annuity or payments under a term certain annuity for a substantial period because of the abuses which might result. For example, an employee who begins to receive an annuity at age 60 could obtain substantial deferral of tax by rolling over each annuity payment into an IRA. No distributions would be required to be made from the IRA until the participant reached age 70-1/2 and then the amounts which would be required to be distributed would be less than the amounts otherwise includible in the employee's income from the qualified plan. Since the purpose of allowing for tax-favored retirement plans is to provide for retirement savings, we believe a rollover in these annuity situations would be inappropriate since the ultimate beneficiary of the retirement plan might be someone other than the employee or the employee's beneficiary.

We believe that the expanded rollover rules of H.R. 4473 would simplify the law in the area of rollovers and will prevent the harsh results that can now occur.

While we support the concept of H.R. 4473, we are concerned that it may have a negative impact on revenue in the short term and we therefore cannot support this bill until we know what the revenue impact would be. This could occur because partial distributions would otherwise be taxed at an individual's marginal tax rate, as would earnings on the after-tax portion of the distribution. H.R. 4473 will exclude partial distributions that are rolled over from current taxation and will increase the pool of tax-sheltered earnings until IRA distributions begin.

H.R. 3191 -- Deductibility of Expenses of Attending Conventions on Domestic Cruise Ships

Background

The restrictions placed on the deductibility of expenses relating to foreign conventions were first enacted in 1976. At that time, Congress recognized the growing practice among professional, business, and trade organizations to sponsor cruises, trips and conventions during which only a small portion of time was devoted to business activity. The promotional material often highlighted the deductibility of expenses incurred in attending a foreign convention and, in some cases, described the meeting in such terms as a "tax-paid vacation" in a "glorious" location. In short, many taxpayers were attending foreign conventions that were really thinly-disguised vacations and then deducting these personal vacation expenses as business expenses. Deductions for attending foreign conventions had thus become a source of tax abuse.

In response to the problem, Congress adopted rules which allowed the claiming of deductions for two conventions per year if the primary purpose for the trips was business and not pleasure. These rules did not eradicate tax-subsidized vacations, however, and were therefore supplemented in 1980 with a "reasonableness" test.

Under this test, the expenses of attending a foreign convention, seminar, or similar meeting are not deductible unless it is more reasonable to hold the convention outside the North American area than within it. The factors to be considered in determining reasonableness of the convention site are: the purpose and activities of the convention; the purpose and activities of the sponsoring organization; the residence of active members of the sponsoring organization; and the places at which other meetings of the sponsoring organization have been held.

For example, if a significant portion of an organization's members resided in France, it could be considered more reasonable for the organization to hold a convention in France than in the United States. Similarly, if the members of an organization composed of individuals engaged in a certain type of business regularly conducted a portion of their business in Germany, it could be considered more reasonable for the organization to hold a convention in Germany than in the United States.

H.R. 3191

Under the present statute, a convention held on any cruise ship is not considered as satisfying the reasonableness test and no deduction is allowed in connection therewith. H.R. 3191 would modify this rule and permit the deduction of attending a convention, seminar, or similar meeting held on a domestic cruise ship if all ports of call of such cruise are inside the North American area. A domestic cruise ship is defined to mean any cruise ship documented under the laws of the U.S.

Treasury is strongly opposed to H.R. 3191.

The reasonableness test adopted in 1980 was intended to deal with the primary problem with foreign conventions, namely, the selection of the foreign site because of vacation motives without regard to business considerations. Even though a convention benefits a taxpayer's business to some degree, there is no justification for a tax deduction where the convention is held at a foreign site having nothing to do with the taxpayer's business. In such cases the personal benefit predominates.

We think this reasoning is sound and applies particularly to conventions held aboard cruise ships. The only reason for holding a convention or seminar on a cruise ship would be for personal enjoyment. It would be a rare case where a cruise has any connection with the topic of the convention or with the organization. In short, we think allowing a deduction for expenses of attending a convention aboard a cruise ship would too closely resemble a tax-subsidized vacation. It is the type of deduction that discredits our entire tax system.

H.R. 4444 -- Capital Expenditures Limitation on Small Issue Industrial Development Bonds

Under present law, interest on IDBs is generally not exempt from Federal income tax since the bond proceeds are used in a private trade or business and payment of the bonds is derived from the business. Exceptions are provided, however, for certain quasi-public "exempt facilities" (such as airports) and for certain "small issues." The small issue exception applies to single issues of $1 million or less, if the bond proceeds are used for land or depreciable property.

At the election of the issuer, the $1 million cap may be increased to $10 million, provided that all outstanding exempt small issues plus other capital expenditures (not financed out of exempt small issues) within a 6-year period with respect to the business project are aggregated for purposes of the limitation. This $10 million cap on the aggregate of prior issues and capital expenditures has the effect of denying tax-exemption to IDBs used in connection with large and expensive projects.

Under Treasury regulations, the amount of capital expenditures is determined under the usual tax rules for distinguishing capital charges from currently deductible expenses. Thus, the research and development cost of developing a new formula, product or other capital asset with respect to the IDB project are capital in nature and now count against the $10 million cap.

H.R. 4444 would alter this result. It would provide that R&D which the project user elects to deduct currently under section 174 would not be counted as capital for IDB purposes. Section 174, of course, was originally enacted not to change the general characterization of R&D from capital to noncapital, but only to allow otherwise capital R&D expenses to be treated in effectively the same manner as ordinary deductible expenses.

Even though R&D generally is capital in nature, we believe that the proposal to treat it as noncapital for IDB purposes has some merit. The interaction of the R&D rules and the section 103 small issue requirements could, in some cases, have the effect of creating an inequitable bias against R&D-intensive firms desiring to make use of the small issue exemption.

Given this background, we must balance the perceived need to encourage R&D activities against tax policy considerations which militate against creating an exception to the general Code treatment of R&D as capital in nature. We must also recognize that we are not writing on a clean slate. Substantial tax incentives for R&D were enacted as part of the Economic Recovery Tax Act of 1981. Finally, we must consider the appropriateness of piecemeal change to the tax rules governing IDBs -- an area fraught with numerous and very basic unresolved questions. A comprehensive reexamination of this area by Congress is clearly in order. We are therefore of the view that it is inappropriate to make the change effected by this bill in the absence of a complete review of the basic issues presented by section 103.

In addition, several technical points should be stressed. First, it is not clear whether the bill applies only to items such as labor and supplies, or whether it also applies to capital R&D equipment and leased quipment. H.R. 4717, passed by the Senate in December of last year, applies only to labor and supplies and we think it is a sound rule. Second, H.R. 4717 has, properly in our view, delimited the scope of permissible R&D expenditures in one other way: The exclusionary rule is not extended to contract research expenses. Particularly in light of the substantial tax credit for such expenditures and current budgetary constraints, we feel that this limitation is appropriate. Third, we think any new rule should only apply to R&D expenditures made after the date of enactment. H.R. 4444 provides for retroactive change of treatment and is deficient in that regard.

H.R. 2597 -- Membership Requirements for Veterans Organizations

Since 1969, Code section 501(c)(19) has granted tax-exempt status to certain groups of veterans. In order to qualify for such status, the group must be composed of at least 75 percent war veterans. The remaining 25 percent must be substantially composed of veterans (other than war veterans), veterans' widows or widowers, and military cadets. A war veteran is defined by the regulations as any person who served in the U.S. Armed Forces during a period of war (including the Korean and Vietnam conflicts).

Prior to the enactment of section 501(c)(19) in 1972, the veterans organizations generally qualified for exemption as social welfare organizations under section 501(c)(4) or as social clubs under section 501(c)(7). This special category of exemption was created to allow veterans organizations more advantageous treatment with respect to their unrelated business income from the sale of insurance coverage. Qualifying veterans organizations are exempt from unrelated business income tax on any amounts attributable to payments for life, sick, accident or health insurance coverage with respect to members or their dependents, provided that such amounts are set aside for purposes of providing for the payment of insurance benefits or for a qualified charitable purpose.

The problem faced by these organizations is that the combination of a prolonged period of peace and the natural attrition rate among surviving war veterans is rapidly reducing the percentage of "war" veterans in section 501(c)(19) organizations. H.R. 2597 would amend the membership test of section 501(c)(19) to provide tax exemption for an otherwise qualifying organization, provided that at least 75 percent of its members are past or present members of the U.S. Armed Forces, without regard to whether these veterans had served during a period of war.

Treasury opposes H.R. 2597 because we oppose any expansion of a rule which exempts from subchapter L (dealing with the taxation of life insurance companies) an organization which engages in the life insurance business at a time when the taxation of life insurance companies is under active study by the Treasury Department.

H.R. 4577 -- Transfers of Restricted Stock

Prior to ERTA, any taxpayer who received stock subject to section 16(b) of The Securities Exchange Act of 1934, (under which an "insider's" profit may be recovered by a corporation if the stock is sold within 6 months of receipt), was required to treat the value of the stock (less any amount paid) as compensation when received.*/ Section 252 of ERTA revised this rule, on the theory that restrictions on transferability which are mandated by Federal securities laws or accounting principles should be taken into account in determining the time in which the value of the stock should be included in income. After ERTA, any taxpayer who receives stock subject either to section 16(b) or to the "pooling-of-interest" accounting rules will be treated as being subject to a substantial risk of forfeiture within the meaning of Code section 83 for the 6-month period during which the mandated restrictions apply. Thus, the employee will include in income, and the employer may deduct at the time the restriction lapses, the difference between the value of the stock at that time and the amount paid for the stock (if any). This provision applies to transfers after December 31, 1981.

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*/See Horwith v. Comm'r, 71 T.C. 932 (1979).

H.R. 4577 would make the above-described change in the restricted stock transfer rule retroactive to June 30, 1969, provided that any person who received restricted stock after that date elects the tax deferral. The same effective date appeared in the original version of this amendment to the restricted property rules, section 810 of H.R. 4242. Under this original proposal, any individual who had received restricted stock in the latter half of any year after 1968 could elect to defer tax liability on the value of the transferred property from the year of receipt until the next year (when the restriction lapsed). The original proposal did not, however, provide for any adjustment in the corresponding business expense deduction of the employer, which under the principles of section 83 should be claimed in the same year the property is taken into income by the employee. The statute of limitations would prevent any adjustment in returns filed up to 14 years prior to the time of an employee's election, thus defeating the correlation between employer deduction and employee inclusion that is mandated by section 83. When this provision appeared in the Conable-Hance II bill, it was given prospective effect only. It was this version which was supported by Treasury and which ultimately became law.

Treasury continues to oppose any retroactive application of ERTA's change in the restricted property rules. This opposition is consistent with our general oppostion to retroactivity even where, as here, the substantive change in the law is sound.

There are additional reasons why retroactivity is inappropriate in this case. First, by going back to 1969, the bill would permit taxpayers to elect to open years closed by the statute of limitations. The purpose of a statute of limitations is to prevent both the Internal Revenue Service and taxpayers from reopening issues after a certain period of time regardless of how meritorious the position may be. This legislation would clearly violate that rule. Secondly, the bill does not simply apply the new rule to past years. Rather, it provides taxpayers with the option of applying either the old rules or the new rules. Such an optional substantive rule does not represent sound tax policy.

For these reasons, Treasury opposes H.R. 4577.

H.R. 5630 -- State Judicial Retirement Plans

Section 457, as added to the Code by the Revenue Act of 1978, generally permits employees of a state or local government to defer compensation under an eligible state deferred compensation plan, if the deferral does not exceed $7,500 or 25 percent of compensation. Amounts of compensation deferred under an eligible plan, plus interest thereon, are includible in the income of the participant or the participant's beneficiary only when paid or made available under the plan (*e.g.*, upon the participant's separation from service).

If a deferred compensation plan fails to meet the requirements of an eligible plan, section 457(e)(1) provides that all compensation deferred under this ineligible plan after January 1, 1982 will be included in income for the first year in which there is no substantial risk of forfeiture. Section 457(e)(2) lists five exceptions to this broad inclusion rule, encompassing plans that are governed by other retirement rules set forth in the Code. These exceptions are: (1) a qualified plan which includes an exempt trust; (2) a section 403 annuity plan or contract; (3) a qualified bond purchase plan; (4) a section 83 arrangement; and (5) a nonqualified but funded trust.

This statutory list of exceptions does not include certain regular but unfunded state retirement plans -- *i.e.*, plans that provide benefits solely by periodic appropriations by the state legislature from the state's general fund. Participants in all such regular state retirement plans are therefore facing current taxation of amounts deferred under the plan as of January 1, 1982, when section 457 took full effect.

It is clear from the legislative history of section 457 that unfunded regular retirement plans of a state were not intended to be disqualified by section 457(e)(1) (notwithstanding the limited exceptions provided by section 457(e)(2)). See H.R. Rep. No. 95-1445, 95th Cong., 2d Sess.

57 (1978); S. Rep. No. 95-1263, 95th Cong., 2d Sess. 70 (1978). The fact that the legislation was prompted by the Service's position under Prop. Reg. § 61-16, pertaining to compensation deferred under an individual option, and the fact that the statute speaks in terms of an agreement for deferral, provide further indication that Congress did not intend to disqualify those mandatory unfunded state retirement plans that provide no opportunities for individual salary reduction arrangements.

The proposed regulations under section 457 (issued on December 29, 1980) requested comments with respect to whether regulations could appropriately be drafted to exclude unfunded regular retirement plans from the current taxation rule of section 457(e)(1). However, given the clear and unambiguous language of the statute, Treasury and the Internal Revenue Service have been unable to justify drafting a regulatory exception which would accomodate certain unfunded state retirement plans but which would not exclude from section 457(e)(1) those ineligible plans that properly belong within its scope.

Pending clarification of the status of all unfunded state retirement plans, Treasury has provided in its proposed regulations under section 457 that the income inclusion rule of section 457(e)(1) will apply only to compensation deferred under these plans after December 31, 1981. (See Prop. § 1.457-3(c).) The final regulations under section 457 can be expected to contain the same rule. As a result, participants in these unfunded state retirement plans will not be penalized as of January 1, 1982, by the current inclusion in income of all amounts deferred under these plans during the 1978-81 transitional period.

H. R. 5630 provides statutory clarification of the unfunded state retirement plan issue only for certain plans covering state judges. Specifically, the bill exempts certain qualified state judicial plans from the income inclusion rule of section 457(e)(1), provided that such a plan meets the following requirements:

(1) has been in existence continuously since 1978;

(2) requires 100 percent participation by eligible judges;

(3) bases contributions on a uniform fixed percentage of compensation;

(4) includes no salary reduction options;

(5) provides retirement benefits for each judge equal to a percentage of the compensation of all judges of the state holding similar positions (Texas provides for a deferral of 6 percent of judges' compensation); and

(6) pays no benefits in excess of the section 415(b) limits.

A seventh requirement, which would have prevented judges participating in the plan from being eligible to participate (on the basis of judicial service) in any other state deferred compensation plan that qualifies under section 457, appeared in S. 1855 and in H.R. 4881, the original version of H.R. 5630, but has recently been deleted from this bill.

Treasury supports H.R. 5630, based upon our recognition that certain state unfunded plans were not intended to be covered by the section 457(e)(1) disqualification rules. We would also recommend, however, that Congress make a future attempt to exempt from section 457 other state unfunded retirement arrangemuents which are not judicial plans, but which are also unfairly disadvantaged by section 457(e). This broader exception, which would apply generally to regular state retirement plans, should cover any defined benefit pension plan established and maintained by a state (or by a political subdivision, agency, or instrumentality of a state) for the exclusive benefit of state employees, even if the plan is unfunded, provided that --

(1) the plan has been continuously in existence since December 31, 1978;

(2) the plan benefits a significant number of employees, all of whom are similarly situated;

(3) all employees eligible to benefit under the plan are required to participate, and, if contributions to the plan are required, to contribute the same fixed percentage of their basic or regular rate of compensation under the plan;

(4) the plans applies uniform retirement methods to determine the accrued or vested benefits of participants under the plan;

(5) the plan cannot pay benefits with respect to any participant which exceed the limitations on benefits permitted under tax-qualified plans; and

(6) the plan provides no option to plan participants as to contributions or benefits the exercise of which would affect the amount of any participant's currently includible compensation.

H.R. 1808 -- Tax-Free Transfers of Imported Beer

Present law provides separate excise tax rules for domestic and imported beer. Domestically produced beer is subject to a $9 per barrel excise tax ($7 per barrel for certain small producers) at the time the beer is removed from the brewery for consumption or sale. Imported beer is subject to a $9 per barrel tax at the time the beer is removed from customs custody, even if the beer is then transferred to a domestic brewery.

H.R. 1808 would change the point of imposition of the excise tax on imported beer from the point of removal from customs to the point of sale from the brewery, in the case of any beer brought into the United States in bulk containers. Because bulk beer can be stored indefinitely and transferred (either in the pressured containers or by pipeline) tax-free between producers and bonded warehouses, this bill could provide a lengthy deferral of excise tax liability for all beer imported in these containers. Treasury understands that very few domestic brewing companies currently import beer in pressurized bulk containers for bottling in the United States. The bill would place these few with the capability of importing container beer at a competitive advantage relative to those importers that will continue to be liable for excise taxes at the point of removal from customs custody. Treasury believes that the beer excise tax should continue to be imposed uniformly on all importers of beer at the point of removal from customs custody, and therefore opposes H.R. 1808.

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I would be pleased to answer any questions you may have.

Chairman **Stark**. Thank you very much.

Mr. Secretary, I wonder for purposes here of helping those members of the subcommittee who would like to inquire if you could take this committee report, if you have a copy, and on the contents page just go down, if we can, the bills by number and grade them for, against or neutral and then I will let the members of the subcommittee—do you see on the contents they go one, two, three, four, right down the line there, starting with H.R. 612?

Mr. **Chapoton**. I would be happy to, Mr Chairman.

H.R. 612 and H.R. 2981 both relate to withholding on gambling. We are opposed to any change in the rules on gambling winnings. We think the withholding rules work as intended.

H.R. 1808, which was the last bill I mentioned, would allow tax-free transfers of imported beer from Customs' custody to domestic brewery. We think that would give an unfair advantage to breweries that import in containers and would allow substantial deferral of the tax from the point at which it is now paid. Therefore, we would oppose H.R. 1808.

H.R. 2597 relates to membership requirements for tax exempt veterans organizations and would basically remove the requirement that 75 percent of such organizations' members must have served during a time of war. We are sympathetic to the fact that the organization makeup makes it more difficult to meet that requirement. We have no difficulty with these organizations retaining tax exemption, but we have serious reservations about their ability to sell insurance, not being subject to unrelated business income, and so we do oppose in its present form H.R. 2597.

H.R. 2647 would increase the withholding threshold on gambling winnings and, for the reasons stated earlier, we think the threshold withholding adopted in 1976 is appropriate, and we therefore would oppose H.R. 2647.

H.R. 3191 would extend and allow deductions for attending a convention on a domestic cruise ship. We would oppose that for the reasons I have stated.

H.R. 4444 would exclude research and development expenditures from the capital expenditure limit of industrial development bond financing. We are sympathetic with the reasons for this change. We do think that the R. & D. rules probably operate with an unintended effect when applied in the industrial development bond area, but we are reluctant to agree to a piecemeal amendment of those provisions and would prefer that this problem be handled as part of an overall change of tax exempt industrial development bond financing.

H.R. 4473 relates to rollovers of partial distributions under qualified plans and tax-sheltered annuities. We think enlarging the area of tax-free rollovers is desirable and therefore we support the concept of H.R. 4473. Before we could support the bill we would want to make sure that the potential revenue loss is not too significant. As I mentioned, our initial review indicates it probably will not be significant.

H.R. 4577 would make the 1981 act changes on restricted stock rules, which were adopted in 1981 with our support, effective for years after 1981. This bill would make those changes retroactive to

1969 and we oppose it because we consistently oppose retroactive tax legislation.

H.R. 4592 would repeal withholding on gambling winnings and would modify the informational reporting requirements and would provide carryovers and carrybacks of net gambling losses. We oppose those changes.

H.R. 4990 relates to the tax exempt status of athletic organizations providing facilities or equipment. We support the basic approach of H.R. 4990, with a few more technical reservations stated in our written statement.

H.R. 5630 relates to deferred compensation plans for State judges. We support H.R. 5630 and would suggest that it be broadened to cover deferred compensations plans for State employees at a broader level and not be limited to State judges.

Chairman **Stark**. Thank you. At this point I would like to ask if Mr. Duncan has any questions on any of the bills and, if not, we will give you all a chance to ask questions.

Mr. **Duncan**. Thank you, Mr. Chairman. I would like a further explanation of H.R. 1808 on the importation of beer.

Mr. **Chapoton**. Yes. The present rule is that the import duty on beer is imposed when the beer is removed from custody of Customs. This would say that it is not taxed until it is, if it is imported in containers, until it is sold by the brewery.

It would in effect provide an advantage for certain breweries that are now able to import beer in containers and would constitute a very substantial delay in the payment of import duty on beer. So it would both delay the payment of the duty and would give certain breweries an advantage over others.

Mr. **Duncan**. It would be a disadvantage to the small brewers that we are seeing going out of business all over the place?

Mr. **Chapoton**. I cannot say they would be going out of business.

Mr. **Duncan**. Would it help them at all?

Mr. **Chapoton**. Presumably it would.

Mr. **Duncan**. Why should imported beer in bulk be treated differently?

Mr. **Chapoton**. We are saying it should not be.

Mr. **Duncan**. Should not. Thank you. Thank you, Mr. Chairman.

Chairman **Stark**. While we are on this, does anybody else have any questions on H.R. 1808? I did have one, Mr. Secretary.

As I understand it, if you import bulk distilled spirits and rebottle, the excise tax is paid when the bottle leaves the bond, right?

Mr. **Chapoton**. Yes.

Chairman **Stark**. If you import bottled beer you do not pay the excise tax until the bottle again leaves the brewery or the bond. Is that correct?

Mr. **Chapoton**. I am not certain about that, Mr. Chairman. I am informed that any imported beer is taxed when it leaves Customs' custody, not at the later time.

Chairman **Stark**. What you are saying, then, is if imported beer comes in in a bottle or a pony-sized keg or a huge container, all three pay the excise tax at the same time.

Mr. **Chapoton**. That is correct.

Chairman **Stark**. Then I misunderstood. It had been my understanding that you did not pay the excise tax until it was actually sold by the brewery. In the trade this is certainly true of domestically produced beer and distilled spirits. Is that correct?

Mr. **Chapoton**. Domestically produced beer.

Yes, that is correct. There are some different rules for distilled spirits. They are taxed at the later point.

Chairman **Stark**. When do they pay the excise tax on domestic beer?

Mr. **Chapoton**. When it is sold by the brewery, at the later point.

Chairman **Stark**. So we are giving an advantage to good old American breweries?

Mr. **Chapoton**. There obviously is an advantage to domestically-produced beer.

Chairman **Stark**. I was under the impression that you could hold bottled beer and pay on the imported bottle beer when it left the brewery, but for some reason you cannot hold it in containers.

Mr. **Chapoton**. I am informed that that is not correct. We will double check that. If we are in error I will inform the committee.

[Subsequent to the hearing, the Treasury sent the following letter to Chairman Stark concerning H.R. 1808:]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

JUN 1 1982

Dear Mr. Chairman:

On March 16, in testimony before the House Select Revenue Measures Subcommittee, Treasury opposed enactment of H.R. 1808, a bill changing the point of imposition of the excise tax on beer imported in bulk containers from the point of removal from Customs custody to the point of sale from the brewery. Under current law, companies importing beer in bulk containers must pay the excise tax prior to bottling the beer, yet there are no statutory provisions for the refunding of tax on beer that is spilled during the bottling process. In addition, after the tax is paid, imported beer must be kept in segregated parts of a warehouse, and shipped in special trucks, in order to differentiate it from domestic bottled beer (which is not taxed until the point of consumption or sale). H.R. 1808 would cure both of these alleged inequities which hamper the importing of beer in bulk containers.

Treasury opposed H.R. 1808, on the grounds both that the bill could provide for potentially lengthy deferral of excise tax for beer imported in bulk containers, and that the bill offers a competitive advantage to those few brewing companies with the capabilities of importing container beer. Each of these points had been informally confirmed with staff persons at the Bureau of Alcohol, Tobacco and Firearms (BATF), but due to the short notice given Treasury for preparing testimony, no formal bill report was prepared by BATF prior to the hearing on the bill.

During the March 16 hearing on H.R. 1808, supporters of the bill denied that it would permit lengthy deferrals of excise tax, and requested that Treasury re-examine its grounds for opposing the bill. In response to this request, we asked BATF to prepare a bill report on H.R. 1808.

In its bill report (a copy of which is enclosed), BATF states that it has no objection to H.R. 1808, on grounds that the bill would merely provide for bulk beer the same excise tax treatment that is currently available for distilled spirits imported in bulk. Only a short deferral of excise tax payments would result from shifting the point of tax, because imported beer cannot be stored for more than 3 weeks before it is bottled and sold. In addition, by facilitating imports of beer, H.R. 1808 will result in U.S. labor rather than foreign labor being utilized to bottle the beer. Finally, although BATF has not provided any specific revenue estimate on H.R. 1808, there should be only a minimal reduction in revenues resulting from the elimination of the current pre-bottling excise tax on beer that is later spilled during bottling.

BATF recommends that four technical amendments be made to H.R. 1808:

(1) Section 5054(a)(2), not §5054(a)(1), should be amended in order to separate the subsections on domestic and imported beer;

(2) Section 5401(b) should be amended to include this tax liability on the receiving brewer's bond;

(3) Section 5418(b) should be amended to incorporate coverage of the tax drawback, refund and credit provisions of sections 5055 and 5056; and

(4) The bill should be made effective 120 days after enactment.

Based on BATF's analysis and recommendations, and providing that the above-outlined amendments are incorporated in the bill, Treasury supports H.R. 1808.

Sincerely,

/s/ John E. Chapoton

John E. Chapoton
Assistant Secretary
(Tax Policy)

The Honorable
Fortney H. Stark
Chairman, Subcommittee on
Select Revenue Measures
House Committee on Ways & Means
1136 Longworth Building
Washington, D.C. 20515

Enclosure

cc: The Honorable
Richard A. Gephardt

Chairman STARK. Thank you, Mr. Secretary. Do any other members wish to inquire—I am going to go down the list here—on H.R. 612, 2981?

Mr. SCHULZE. Mr. Chairman, do you want to consider the various wagering bills?

Chairman STARK. If you want to deal with any of these bills, there are four—612, 2981, 2647—your bill, Mr. Schulze—and 4592, Mr. Holland's bill. If anybody would like to inquire.

Mr. SCHULZE. I would like to be recognized.

Chairman STARK. I will recognize Mr. Holland at this point.

Mr. HOLLAND. Mr. Schulze and I might pingpong this thing back and forth for a few minutes.

Mr. Chapoton, I think we are trying to find out what some accurate assessment of potential revenue loss would be in these particular pieces of legislation that have been offered, possibly to streamline the Tax Code rather than a great amount of regard for the revenue impact.

Is it Treasury's assessment that in 1982 any one or all of these bills would result in a revenue loss of $20 million or so?

Mr. CHAPOTON. Mr. Holland, I think I can state I do not want to be pinned down to a figure. I think I can state that none of these would be of major revenue impact.

Mr. HOLLAND. Would that be because it does cost something to enforce these withholding statutes. The cost to the Government, as I understand, probably exceeds the net revenue to the Treasury in this particular area. Is that a fair statement?

Mr. CHAPOTON. No, I don't think that is the case at all.

Mr. SCHULZE. Would the gentleman yield on that point?

Mr. HOLLAND. I would be glad to yield.

Mr. SCHULZE. Buck, I have heard this allegation off and on. I wonder if you have any figures for us on the number of individuals and costs involved with collection of this particular withholding tax. I have heard people from the track say that they almost have one man behind every cashier and that kind of thing.

It is very difficult for us to get a perspective on it and I wonder if there are any definitive reports that can tell us how much time is actually spent on this because if we are spending more money than it is worth collecting it, I think we ought to eliminate it.

Mr. CHAPOTON. Well, from the Internal Revenue Service's standpoint it is certainly not more. The effort is less than when you must worry about compliance. In general, withholding is, from the Internal Revenue standpoint, the least burdensome method.

Also keep in mind that these provisions, and particularly for horseracing, apply only to the very unusual bet, that is, where the odds are more than 300-to-1 and therefore it seems unlikely that there is any substantial burden at the tracks.

Mr. SCHULZE. That is sort of up to us to determine and we cannot determine that unless we have the figures. If some of the allegations are true, then an awful lot of agents are spending an awful lot of time at the tracks just looking over cashiers' shoulders. I would like to know that and I wonder if you can supply us with that information. If you do not have it now you can supply it to the subcommittee.

Mr. CHAPOTON. As you know, Mr. Schulze, there was a study under the 1976 act involving the year 1977. That study went into the compliance question and the effect of these provisions on compliance and the number and type of taxpayers that were affected, and whether they had tax liability or not, as a result of the winnings in question.

Studies showed that they did in all but a very small percentage of the cases. The study was not directed at the problem which you address. Indeed, the congressional mandate at that time seemed to be concerned with whether the reporting requirements should be lowered.

Mr. SCHULZE. We have a copy of the study here and are very much aware of it. I guess what I am trying to do is get an answer to my question.

It seems to me the IRS must know where its agents are and what they are doing. If collection of this tax is a major problem, you can tell me why it is a major problem.

Mr. CHAPOTON. No, from the IRS standpoint it might be a problem—not a major problem, but it would be more difficult for us to determine how burdensome it is on a particular track.

Mr. SCHULZE. I am not concerned about the burden on the track. I want to know how many agents are assigned to this, how much time they spend on it, their annual salaries, and that kind of thing so that we can determine in an intelligent way whether this effort is worthwhile.

Mr. CHAPOTON. Well, we can certainly do that. We can certainly tell you what IRS effort is involved as a result of this.

[No response had been received up to time of publication.]

Mr. SCHULZE. I thank the gentleman.

Mr. HOLLAND. I would concur with Mr. Schulze's request that you do provide that, if it is at all possible.

Additionally, I have watched in somewhat a state of alarm as the Treasury Department, through the past administration and now into this administration, has been something of a champion of universal withholding. You want to withhold on dividends and interest. You want to withhold on independent contractors.

I am wondering if this small, nonrevenue protective provision and your position on it is not just another piece in the advance toward universal withholding. Isn't that the real reason for your opposition to this thrust of the legislation?

Mr. CHAPOTON. First, let me say we have not proposed withholding on independent contractors. You are correct. We have proposed withholding on interest and dividends, a low rate of withholding.

We went back and reviewed withholding on gambling winnings. It applies in the unusual instance where tax liability is most likely to result from the winnings. That is the high winning on a very high odds bet. It seems to us that that is quite appropriate that the tax be collected at the source in that instance.

Mr. HOLLAND. I take it from that response, then, that your main concern is compliance.

Mr. CHAPOTON. Absolutely. Our main concern is compliance.

Mr. HOLLAND. I believe you testified about a bill. I believe it is identical to H.R. 612—S. 1369—in the other Body, and at that time did you bring up the compliance argument to the Senators who were listening about this particular bill?

Mr. Chapoton. What bill is that?

Mr. Holland. It is S. 1369.

Mr. Chapoton. What does it relate to? I am sorry.

Mr. Holland. It is Senator Huddleston's bill. It is identical to H.R. 612 which is before you.

Mr. Chapoton. I do not believe I have testified on that bill.

Mr. Holland. All right. I think the administration has made some magnificent motions toward what is called the New Federalism. Don't you think if we got the Federal Government and the Internal Revenue Service, out of the operations which are admittedly limited to a few States in the United States, that it would be the greatest step toward the New Federalism in allowing these revenue potentials to just remain with the State and local governments?

Mr. Chapoton. Mr. Holland, I have heard that concern about the withholding on gambling winnings, but such winnings are taxable income and appropriate compliance measures are necessary.

I think the question is whether current law is appropriate or whether stronger or not as strong reporting requirements are necessary. It seems to us that the reporting requirements make sense and that some withholding in the unusual case also makes sense.

Mr. Holland. It is, though, a fact that most of this type of operation is tightly controlled by the State government in which the activity occurs.

Mr. Chapoton. That is correct.

Mr. Holland. My statement or argument or request to you—or I would ask, if you concur that those would be the political subdivisions most equipped to manage whatever tax problems they want to impose on this type of activity rather than at the Federal level where, as Mr. Schulze alluded, we have agents out looking over shoulders in race tracks and so forth. It seems to me the States have proven they can adequately do that and control this type activity.

It is sort of contradictory to me that your position today seems to reject the philosophy of New Federalism.

Mr. Chapoton. Mr. Holland, the philosophy of New Federalism doesn't say we do not collect Federal income taxes. Indeed——

Mr. Holland. Well, it should say that we do not waste money collecting taxes where there is no revenue available to help the Treasury.

Mr. Chapoton. Well, that is correct, and if we thought that were the case, we would not support these provisions.

Mr. Holland. Then I would argue to you, sir, that the imposition of the bureaucracy and the attendant costs into whatever activity the Federal Government can find is a contradiction of the philosophy of New Federalism.

Mr. Chapoton. The IRS is, under law, required to seek compliance with the legal requirement that gambling winnings are taxable income. The point I think we would all agree on is that that ought to be done at the lowest cost.

Withholding obviates the necessity of agents being out there looking over specific winning transactions, and reporting requirements, where they work well, also obviate that necessity.

Mr. HOLLAND. You would agree with me, though, that there is an economic burden placed both on the Internal Revenue Service and on the company conducting these enterprises.

Mr. CHAPOTON. No; I think it is less of a burden on the Internal Revenue Service than the burden would be absent the reporting and withholding. It reduces the effort at the IRS level and it increases it to some extent at the track or at the withholding level.

Mr. HOLLAND. You do not agree with the bill's position that reporting and informational returns are adequate to enforce the law?

Mr. CHAPOTON. No, I do not.

Mr. HOLLAND. I believe it has been your position specifically on the independent contractor issue that informational reporting in that instance probably would result in compliance with the law.

Mr. CHAPOTON. We are addressing that question right now, Mr. Holland. We have not taken a position yet, but we will be doing so next week before this subcommittee.

Mr. HOLLAND. The subcommittee will be listening intently for your statement.

I yield to Mr. Schulze.

Chairman STARK. If I could, I will recognize Mr. Guarini at this time.

Mr. GUARINI. Mr. Chapoton, I want to get down to the logic of the administration on H.R. 3191, which concerns the treatment of expenses incurred for conventions on domestic cruise ships. I have always believed and it has always been my train of thought that a ship——

Chairman STARK. Would the gentleman suspend a moment? We are trying to go through these one at a time in the order.

Mr. GUARINI. I thought we had.

Chairman STARK. You have a schedule problem also, do you not?

Mr. GUARINI. Yes, sir. I have to be on the floor with a bill at 12.

Chairman STARK. You may proceed.

Mr. GUARINI. Let the chairman go through his usual routine because I assume that it will not be very long before Mr. Chapoton will be through, so I will take my turn at the appropriate time.

Chairman STARK. Thank you very much. Are there other members who would like to inquire on the four gambling bills?

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Secretary, I was intrigued with your statement that the main concern is compliance. I am inclined to agree with you to a point, but isn't it true that the compliance rate when there was merely reporting was over 70 percent—and I think that is fairly good. However, the highest compliance rate was on State lotteries, which was 91 percent.

Mr. CHAPOTON. That is correct.

Mr. SCHULZE. So it seems to me that if we want to get the highest compliance rate you would be eager to endorse my measure which brings this up to the same level as the highest compliance rate.

All I am trying to do is get equity. I am not trying to eliminate reporting necessarily, but I do not see why one class is held differently than another and since this is the highest compliance rate, wouldn't it be in your best interests to bring it up to that level?

Mr. CHAPOTON. Well, we are dealing with a different type of winner, if you will. We are in perfect agreement that we are trying to achieve the highest compliance rate. I don't think we can take the compliance level in the State lottery and say that the information reporting requirements there indicate that those same levels would achieve the same degree of compliance in other areas.

Mr. SCHULZE. Why not?

That is certainly a good guide or indication. It is the only thing that we have to go by, and the compliance rate is over 90 percent and that is a pretty good average.

Mr. CHAPOTON. We have the same type of information reporting in the other areas and the compliance rate is much lower.

Mr. SCHULZE. But still the compliance rate when there was only reporting was over 70 percent, and that is really not bad. But 90 percent is better and it seems to me we are talking about an absolute minimal revenue loss of something like $11 million. That would be in everybody's interest to raise it to that level. It would also, I am inclined to think, decrease the expense of collection a great deal.

Mr. CHAPOTON. Mr. Schulze, it doesn't decrease the IRS expense of collection through the withholding system. But let me hasten to add that 70 percent compliance is not very good compliance. That is pretty bad compliance. We would be concerned about that level. So we think something should be done.

Mr. SCHULZE. But we are still talking about a miniscule amount when we compare it to the figure that I saw. Something like $70 billion is not being sent in. Wasn't that the figure a week or so ago?

Mr. CHAPOTON. Yes, that was Senator Dole's figure, I believe.

Mr. SCHULZE. I would like, with the chairman's indulgence, to put this in just a little bit of perspective.

What we are talking about in the horse industry is a $10 billion a year effect on our economy. This is a pretty large industry and provides employment for a wide range of people, from some fairly sophisticated, highly-trained individuals to some who are marginally employable, the lowest rung of the ladder. We are providing employment opportunities for those people.

Everything that we do to decrease those opportunities, for such a small amount of money, is foolish. We are wasting the time, effort, and money of the Federal Government.

Mr. CHAPOTON. Mr. Schulze, these rules have been in effect for 4 years and the industry seems to be thriving.

Mr. SCHULZE. I can give you specific examples. I think it was Charlestown, W. Va., that almost went out of business. It had to be subsidized by the State government.

Now I am not saying it is totally because of this, but it had a partial impact. I am sure you are aware of the effects of the churn and what it does in the horse-breeding and raising industry. It is a very positive industry in our country, one that is highly beneficial from an ecological standpoint and for the preservation of open spaces. I think it is one of the most beneficial industries in our Nation.

Direct revenues to governmental entities is over $1 billion. It seems to me the small amount that we are talking about is peanuts. Rather, we should be doing everything we can to make a healthy industry. We are talking about $200 to $300 million of exports.

I am also on the Trade Subcommittee, and this is important. We should be, if anything, doing everything we can to encourage this industry instead of discouraging it. I think that the equalization of the withholding tax with the tax on State lotteries is correct as a matter of equity. I hope that you will reconsider your position because H.R. 2647 is a rational middle ground which we should support, not only from a revenue standpoint, but because of its equity.

I am a member of the President's Commission on Federalism. We have to start looking for revenue sources for the States instead of turning only obligations back to the State. We also have to view their sources of income. It seems to me this would be an ideal source of income for States and municipalities to fund local activities and I think, as Mr. Holland pointed out, it might be more beneficial in the long run for the Federal Government. We might end up with more income than we are now receiving.

I thank the gentleman for his testimony and I thank the chairman.

Chairman STARK. Are there further inquiries on this topic? If not, are there any people who would like to inquire on H.R. 2597? I do have some concern of my own, Mr. Secretary. I am concerned that various officers; enlisted mens' organizations, and disabled veterans groups will not be able to carry on their traditional activities if we do not allow them to change because our country has been successful in staying out of war?

As I understand it, if a person is not a war veteran, certain benefits will be lost by these veterans' organizations. What are they to do?

Mr. CHAPOTON. I agree that the time involved since the United States has been in a war makes it increasingly difficult for these organizations to qualify under the present special category, 501(c)(19), because of the requirement that 75 percent of their membership must meet the war requirement.

Before that came into law, which I believe was 1969, these organizations did qualify for exemption, as I understand it, as civic organizations or social clubs. They could presumably qualify under those rules still. Or perhaps special other types of amendments could be made to (c)(19) to take care of this problem.

Our only concern is the fact that their sales of insurance are not subject to the unrelated business income tax where sales of insurance by those other tax exempt organizations would be subject to the unrelated business income tax. We have got a lot of problems in the insurance area right now, and to allow the significant broadening of the membership of the organization—which would in turn broaden the class which can participate in insurance with no tax either at the insurance entity level or at the policyholder level—is of serious concern for us.

Now when we look at the insurance area more closely, our concern may or may not dissipate, but I suspect it will not.

Chairman STARK. Do you have any idea what the magnitude of the insurance sales are and membership participating in the insurance part of these organizations?

Mr. CHAPOTON. No, Mr. Stark. I do not, and I want to obtain that information, but we do not have it now.

Chairman STARK. I suspect that these organizations have a large number of activities—some of it is, quite frankly, lobbying on behalf of issues that are important to veterans. I am a veteran myself but I never had to serve during an active conflict.

But we were all requested and in some cases required to serve for the defense of the country and that may be what kept us out of war. So I find it somewhat difficult to in effect discriminate against the person who was drafted or volunteered when we asked them to just because they did not get shot at.

My hypothetical question comes down to this. If these organizations were not attempting to run an insurance company under the guise of a veterans' membership organization—in other words, insurance was not the major function—could we then draft legislation that would grandfather in existing organizations, while preventing this future loophole from existing? Might the Treasury's opposition to this bill then subside?

Mr. CHAPOTON. We could work along that line. Our concern is that there might be substantial growth in this activity absent or with this amendment, so I think you are correct. We do need to learn the extent of the insurance activity as a part of their overall activities, and I think that would be a relevant factor.

Chairman STARK. I think there may be some informative comments forthcoming from your staff.

Mr. CHAPOTON. Well, we do need to pursue that.

Chairman STARK. In the spirit of cooperation which we enjoy from the Assistant Secretary, I would like to have the chance to get some more details on this problem because I think it is excellent legislation and I know Mr. Jones and Mr. Conable both have done a lot of work on it. I think that the intent here is to help worthy organizations and I hope we can find a way to accommodate them.

Are there other questions on H.R. 2597? If not, I would like to recognize Mr. Guarini to inquire on H.R. 3191.

Mr. GUARINI. Thank you, Mr. Chairman.

Mr. Secretary, the logic escapes me on the Treasury Department's position on the treatment of expenses for attending conventions on domestic cruise ships.

First, I always understood that a ship was an extension of our flag, of our territory, and that is as a piece of territory within the continental limits of the United States, wherever it is. That is the legal concept.

But the economic concept also eludes me as to where the administration stands. Cruise ships apparently are labor intensive. One of the greatest problems we have in our country today is unemployment. Today there appears in the Washington Post a note that we have extended favorable tax treatment to conventions in Jamaica, and that full page ads are being taken out by the country of Jamaica in Business Week magazine announcing the great Jamaica tax break, referring to these conventions that they are looking for.

Now we are concerned about jobs in America. How does the administration square away giving Jamaica a tax break on conventions and denying our own people who would be manning these cruise ships the same right?

Mr. CHAPOTON. Well, Mr Guarini, let's go back just a bit.

Mr. GUARINI. I am not concerned about rules. I am talking about people. I am talking about jobs. Where is the logic?

Mr. CHAPOTON. Well, the logic is, addressing the convention and cruise ship first, is that it clearly has been advertised and is thought of and indeed I think is the vehicle for a pure tax deductible vacation arrangement.

Conventions on cruise ships have been so advertised and if the rule adopted by this bill were passed, they would be so advertised again.

Mr. GUARINI. You mean an advertising agency is controlling the tax policies of the Treasury Department?

Mr. CHAPOTON. I mean that indeed they are what they are advertised, that is, a tax deductible vacation and that is not sound. We should not condone that.

Mr. GUARINI. You think Disneyland is more sound? Do you think that Las Vegas is more sound? Do you think that Vail, Colo. or the skiing areas are more sound? I mean, there are so many areas in our country where people go to gather that have the same hotel facilities as a cruise ship would, a city contained within itself with large meeting rooms and dining areas and all the facilities that you would need for the gathering of people, and I cannot see where a cruise ship is not sound and Disneyland or Las Vegas is sound.

Now where's the logic?

Mr. CHAPOTON. I concede that that is one simple step beyond a convention, business convention, held in the other spots. There is no doubt about that.

It is, however, a [illegible] case where the pleasures of the arrangement, the entertainment side of the arrangement, will more than likely predominate.

Mr. SCHULZE. Would [illegible] gentleman yield?

Mr. GUARINI. Yes, [illegible] for one question.

Mr. CHAPOTON. If [illegible] just finish, I think there are concerns indeed on domestic [illegible]ons and we should be very aware of those concerns. It is not a question of whether we are trying to create jobs or not. It is a question of whether tax policy should or should not turn its blind eye to whether deductions are being claimed that are in fact vacations.

Mr. GUARINI. Let me reclaim my time at this point. Isn't it true that the taxpayer still has to prove that the primary purpose was business and not pleasure?

Mr. CHAPOTON. That would be the case.

Mr. GUARINI. Well, if he has to prove it, why should you object to it?

Mr. CHAPOTON. If the law allows this, a lot of claims will be made. We simply know that it is not possible to determine in every case whether those facts are in existence.

Mr. GUARINI. Well, you do make that effort to prove concerning Atlantic City or Las Vegas or any of these other places. I do not see the distinction.

Mr. CHAPOTON. We make the effort in every case. The distinction is that this is one step beyond those.

Mr. GUARINI. One step beyond because of what reason, sir?

Mr. CHAPOTON. Because the cruise ship is oriented to the pleasure aspect and not to the business aspect.

Mr. GUARINI. That is your personal concept. It is probably the imagery that is being created by television. We are talking about real people in real jobs. We are talking about the food and beverage industry. We are talking about the travel and tourism industry. We are talking about shipyards that have to repair these ships. We are talking about an economy that is badly in need of a new industry.

Why can't the administration see the logic in it?

Mr. CHAPOTON. Well, you are suggesting that this should be allowed as an enhancement to an industry without regard to the policy?

Mr. GUARINI. No, the regard is that the primary purpose was business and not pleasure. Now that is the rule of Treasury and they extend it to Jamaica, Canada, and Mexico. Acapulco has as much pleasure orientation as any cruise ship that was ever built. I do not see why you should be opposed to it.

Then, on top of it, it is reported that the tax loss is negligible. When you consider the retrofeed of all of these people that would have jobs in a labor intensive industry, people who would be able to pay income tax, and that you are supporting businesses that would be, in turn, be paying income tax, it seems to me that you are going to end up with a plus instead of a minus.

Mr. CHAPOTON. Well, we have to be careful about analyzing these matters in tax loss in every instance. There is a principle our tax law must follow and we must not undermine the integrity of the system. I think it is important that we in Treasury keep this in mind and that the subcommittee keep it in mind.

Mr. GUARINI. Well, I seriously ask the administration to reconsider their position because it really has, in my mind, no logical basis and I would appreciate it if you would give reconsideration to it, Mr. Secretary.

Chairman STARK. Mr. Schulze.

Mr. SCHULZE. Mr. Chairman, I agree with Mr. Guarini's opinion and point of view and would like to state to the Secretary that in my former life I had the occasion to partake of both types of conventions, and let me say in all candor, if I were going to run one, I would much rather do it on a cruise ship because you have a captive audience.

You have them. They are locked in. They cannot get away and your training sessions and business meetings are going to be better attended than if it is a bright, sunny day and they are out on the golf course. I say that in all seriousness and having been to both types.

I think that you are going to get more compliance, more business-oriented meetings when you are sort of a captive audience on a ship than you are in some——

Mr. HOLLAND. Would the gentleman yield on that?

Mr. SCHULZE. Surely.

Mr. HOLLAND. Didn't the Treasury just add Jamaica to the list of places where people may go and deduct costs?

Mr. **Chapoton**. As Mr. Guarini was pointing out and the Washington Post this morning has pointed out, the new protocol to the Jamaican Treaty does extend to Jamaica so-called North American treatment on conventions as a quid pro quo in a renegotiated treaty.

But the point is well made that conventions can now go to Jamaica not subject to this rule. As Mr. Guarini points out, they will still have to show that the principal purpose of the session is business.

Mr. **Holland**. Then Mr. Schulze's argument that a boat is a much better place to lock up people to get some work done than Jamaica. It seems to me that this thrust would logically follow what the addition to the protocol just accomplished.

Mr. **Chapoton**. Well, there is a concern. There was a concern in this committee and there was concern in the Senate Finance Committee about the protocol, the Jamaican protocol. We undoubtedly have a tremendous problem with the convention question in general and this committee dealt with it at great length in, I believe, 1976.

The only question is, where do you try to draw the line in some reasonable fashion. We dealt with it again in 1980. It was this committee's decision at that time to place cruise ships outside the ambit of the rule, and indeed when you look back over the past literature and advertisement of cruise ship so-called business conventions, I think there was a legitimate reason for the concern that this committee had at that time.

All we are saying is that we support that decision made in 1980.

Mr. **Holland**. I would have to tell the Secretary that the three members you are talking with about this were not members of this committee, I do not believe, in 1976 and we are trying to correct some of the errors that were made back then. [Laughter.]

Mr. **Chapoton**. It was reconsidered in 1980.

Chairman **Stark**. Mr. Vander Jagt.

Mr. **Vander Jagt**. I was a member of this committee in 1976 and struggled vainly against the imposition of the nondeductibility of convention expense on foreign soil. The dialog that we have heard between my good friends and the distinguished Assistant Secretary reconfirms my conviction that I indeed was right then.

You start with an ill-founded premise that is going to lead you to all sorts of ridiculous situations. The problem with conventions is it is not where they are held, it is what people do at the convention. It would be possible to have a hard-working convention where everybody is captive, as my good friend from Pennsylvania describes, on a foreign ship and a pure pleasure cruise on an American ship. The hard-working conventioneers would not have their expenses deductible and the pleasure seekers would.

I am torn on the gentleman's bill. I think the nondeductibility of foreign convention expenses is so obnoxious that I am delighted in a way to try to lift it wherever we can. But, on the other hand, I think it raises a real protectionism problem, especially at a time when foreign conventions for the first time are starting to flow this way.

Mr. **Guarini**. Will the gentleman yield?

Mr. **Vander Jagt**. I would be happy to yield.

Mr. GUARINI. I think there is an impression that should be corrected. We are really talking about North American conventions and not foreign conventions. We are talking about the area of Canada, Mexico, the United States and our own cruise ships, which would be an extension of that.

Foreign conventions in England and Europe and other countries or foreign ships is indeed of a nomenclature with another set of rules governed by the IRS.

Mr. VANDER JAGT. The other subcommittee on which I serve is the Trade Subcommittee. I would want to examine very carefully whether we are running into international trade problems with this. But one thing does intrigue me, Mr. Secretary.

I read the account in the Post too that we have extended this exemption to Jamaica. Since the Congress decided by law that expenses for conventions that are not held in America or Mexico or Canada are not deductible, how can we just by treaty override the statute Congress passed? I am just curious about that.

Mr. CHAPOTON. It is a very valid question. The rule is, though, that the treaty power of the United States is that broad because there is trading and that is the theory behind it.

Mr. VANDER JAGT. Well, I know you have no responsibility for this, but what you are telling me is the administration, in conjunction with the Senate, can just run into the ground whatever the will of the House might have been in regards to legislation.

Chairman STARK. If the gentleman would yield, it would seem to me that we could make this or foreign tax credits the subject of a treaty and have it ratified by the Senate and from this particular Member's point of view destroy the traditional system of revenue bills originating here and being considered by both Houses.

If I may further intrude on the gentleman's time, the chairman of the full committee was quite upset to see this appear in a treaty without consultation with this committee. I would just want to go on record to say that if I saw that happen again I am sure the gentleman from Michigan serving on the Trade Committee understands that we could indeed change trade laws to keep ourselves active in the participation and that if one branch of the Government decides to do something which might very well override the jurisdiction of this committee, it is within the power of this committee to respond.

I would hate to see us start picking at each other's jurisdiction or prerogative by making end runs and that is not exactly the topic of this hearing this morning, but I thought it would be worth reemphasizing—this committee's feeling, I think, on both sides of the aisle about laws being written in that way.

Mr. CHAPOTON. Mr. Chairman, if I might say I think this is a very legitimate concern. Indeed we have had, since that time, much closer consultation with the staff of this committee on treaty matters in general because, as you point out, you can do a lot of things. This is only one example. Indeed, you can deal with the foreign tax credit in a treaty.

Mr. VANDER JAGT. If I may reclaim my time, it seems to me the tax treaties in general deal with agreements between governments. Under this step we are trying by treaty to change the U.S. law as to how we treat our own taxpayers. It seems to me that that gets us skating pretty close to the edge of the ice.

Mr. CHAPOTON. I see your point, Mr. Vander Jagt. It is a subject, though, that is often dealt with by treaties.

Chairman STARK. It is my understanding that if I were to organize a business meeting, say a sales meeting, and if I were to go down to the Potomac River and rent or charter a boat that travels up and down the river, I could deduct the expenses for conducting that meeting on the boat, if it indeed was a business meeting. Is that not correct?

Mr. CHAPOTON. That is probably correct, I would assume, but without looking I could not finally state.

Chairman STARK. Further, if I was a smaller meeting I could go out to Annapolis and charter a 50-foot boat with a captain and have a meeting. In all seriousness, if it was business—in this case it might be a tax symposium and we might be dealing with loopholes and that sort of thing—I could deduct those expenses, could I not?

Mr. CHAPOTON. Yes.

Chairman STARK. Now, how long does the boat have to be before you are going to say no? [Laughter.] It seems to me we are just talking about how long is it if it is a convention and how short is it if it is a chartered yacht.

I really fail to see the distinction.

Mr. CHAPOTON. Well, I think historically we all know that the basis of the distinction was the general convention problem that had arisen and caused this committee to deal with it, and that is conventions where it is more likely than not. There were rules at one time that you had to spend so many hours a day in business at the convention at that time and it was almost impossible to administer. So this clearly was a meat axe approach. It said that for certain kinds of conventions, we are just going to say that we will presume they are nonbusiness. That is what this approach does.

You cannot say that it is not a sound approach.

Chairman STARK. It is my understanding that we have possibly two or three American flagships that would qualify and that the Treasury's feeling is that it is very difficult to see anything but a dilatory purpose in embarking on one of these ships.

But those of us who may have been lucky enough to go to Monokea or Kaneil Bay or some other such Rockefeller establishment and conduct business there, and to say that that is any more conducive to business than a ship that is rolling about to the detriment of your equilibrium and your stomach, I find it hard to say that we aren't really trying to draw a false line.

This is of great concern to an industry in real financial trouble, I just do not see that this would be a growing problem. We don't have that many ships, and I honestly do not think it is very likely that you are going to find foreign flags rushing in to register under our flag. So aren't we talking, literally, about only two or three ships?

Mr. CHAPOTON. I am sure in terms of dollars we certainly are not talking about much in Federal revenues. Of course, you have to understand that the other cases you mentioned are cases for concern also. It does not follow that because the law now authorizes those others that we ought to extend a rule to a case that we think might give us more help.

Chairman **Stark**. I appreciate that, and the Secretary is absolutely correct. It might have something to do with the fact that these few employees who maintain the ships and who operate them and reside in the districts of some of the members of this subcommittee, and that may be part of the concern.

But it does seem to me that we are discriminating, if you will, against a very small segment of an American industry and I would be willing to entertain with the Secretary a discussion of the whole overall question of conventions. In other words, I gather that you would agree with me that the Treasury in this case is trying to keep its finger in the dike and that is the principal basis of your objection.

Mr. **Chapoton**. I would say that is a good description, Mr. Chairman.

Chairman **Stark**. Thank you, Mr. Secretary. Mr. Moore.

Mr. **Moore**. Mr. Chairman, the gentleman from Michigan on my right touched on a subject I would like to follow up on. Mr. Secretary, in the United States, if you hold a convention in a hotel and it qualifies for business purposes it does not make any difference to the IRS whether that hotel is foreign or domestic-owned, does it?

Mr. **Chapoton**. No, it does not. It is the location of the hotel.

Mr. **Moore**. Mr. Secretary, do you feel qualified to render an opinion on behalf of the administration as to whether or not the bill applies only to domestic cruise ships.?

Mr. **Chapoton**. That is right, domestic flag.

Mr. **Moore**. Would that not violate the general trading agreements we have with our trading partners in the world? It seems to me we are offering a tax incentive to hold conventions aboard domestic ships and not offering it to foreign-owned ships. I understand there are a number of foreign-owned cruise ships that do call upon ports in the United States.

Mr. **Chapoton**. Mr. Moore, my offhand reaction would be it would not violate any trade agreements because there is really not any export involved, but I don't feel qualified to express a final opinion on that.

Mr. **Moore**. You are exporting convention business, Mr. Secretary.

Mr. **Chapoton**. But it is not exporting products to a foreign market.

Mr. **Moore**. It is limiting the market in the United States to foreign importers of the business of cruise ships.

Mr. Chairman, I request that we contact the Special Trade Representative's Office to ask them to render an opinion as to whether H.R. 3191 violates U.S. trade agreements, including the General Agreement on Tariffs and Trade. I would also like to keep the record open until this opinion is received.

I think you have got to open it up to any ship that calls in the United States and visits ports in North America, as the bill otherwise provides. I would urge getting an opinion of the Special Trade Representative on that.

Chairman **Stark**. Without objection, we will hold the record open and request that opinion.

Mr. **Moore**. Thank you, Mr. Chairman.

[The information follows:]

THE U.S. TRADE REPRESENTATIVE,
Washington, D.C., June 10, 1982.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR PETE: In a letter dated April 8, you asked us to review whether H.R. 3191 violated any general trade agreement. The provisions or H.R. 3191 would not violate our obligations under the General Agreement on Tariffs and Trade. Essentially the reason is that the GATT does not currently apply to services and the tax exemption contemplated in this case is for a service provided by the cruise ship.

I appreciate your consideration in giving me the opportunity to comment on this legislation.

Very truly yours,

WILLIAM E. BROCK.

AUGUST 12, 1982.

Hon. W. HENSON MOORE,
House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN MOORE: Reference is made to correspondence earlier this year between you and Ambassador Brock regarding H.R. 3191, which would amend the Internal Revenue Code to allow income tax deductions for expenses incurred in attending business conventions held on cruise ships documented under U.S. laws and with respect to which all ports of call are within North America.

In Ambassador Brock's March 29 reply to your letter of March 17, he asked that enactment of the bill would not contravene commitments under the General Agreement on Tariffs and Trade (GATT). He also indicated that we were currently unaware of any potential adverse effects of the legislation on U.S. trade policy initiatives. As preparatory work progresses for the GATT ministerial meeting, which it is anticipated will be held in November of this year, it appears likely that the U.S. will attempt to obtain a contract from our trading partners for expansion of the GATT framework to include international trade in services, including some aspects of shipping. In the event that we do press such an expansion, passage of H.R. 3191, as written, might be somewhat detrimental to our effort as it would be received as protectionist in nature and generally inconsistent with such an application of GATT to services.

An alternative might be to add to H.R. 3191 a qualification that it would not apply to a case in which the President finds its application to be inconsistent with an international obligation of the U.S.

Sincerely,

DAVID R. MACDONALD,
Acting U.S. Trade Representative.

Chairman **Stark**. If there are no further questions on that—and I would mention to the other members that we want to get through as quickly as we can; we want to get to the other witnesses—are there any questions relative to H.R. 4444?

If none, are there any questions relative to H.R. 4473? Are there any questions relative to H.R. 4990.

Mr. **Vander Jagt**. Mr. Chairman.

Chairman **Stark**. Mr. Vander Jagt.

Mr. **Vander Jagt**. I would just like to ask a couple of brief questions on H.R. 4990. As I understand it, Mr. Secretary, when we attempted in 1976 to give tax-exempt status to groups seeking to support amateur sports, including participation in the Olympics, the conference committee inserted a clause that has had a very unintended effect in terms of Treasury issuing rulings and in terms of encouraging our getting ready for the Olympics.

Could you explain what that unintended problem is?

Mr. CHAPOTON. Yes, I would agree with your statement, Mr. Vander Jagt. The problem was that evidently in the conference committee concern was expressed that by creating a special class of exempt organizations for sports organizations qualified to receive tax deductible dollars, you might allow some health clubs to be recipients of tax deductible dollars.

So the clause was added that if the organization provides facilities or equipment it is not an eligible recipient. That has the unintended effect of denying the special classification to the organizations it was intended to benefit.

It has sort of been exacerbated because some organizations now are having difficulty getting back under the rules they were previously under, so we think we definitely need to clean this up along the lines of your bill.

Mr. VANDER JAGT. It would be pretty hard to promote amateur sport participation without some facilities. Unfortunately, the language that was inserted at conference prohibits that and that is clearly an unintended effect.

It is my understanding that you have a number of ruling applications backlogged at Treasury that you have not wanted to deny because it clearly is against what Congress intended. Yet, unless there is a change in the law, you would have to deny these groups their tax exemption.

Mr. CHAPOTON. Right. They were not issued the denials and we don't want to, but we cannot read the statute as approving them. So we do seek this legislative change as soon as possible.

Mr. VANDER JAGT. So assuming we can get some of the technical problems cleaned up, Treasury is strongly in support of this legislation and feels a rather desperate need for it this year.

Mr. CHAPOTON. That is absolutely correct.

Mr. VANDER JAGT. Thank you. Thank you, Mr. Chairman.

Chairman STARK. Thank you, members of the subcommittee. If there are no further questions, I want to thank you, Secretary Chapoton, for your cooperation and patience with us this morning.

The Chair would like to say, as I mentioned earlier, we will be taking this somewhat out of order, as members who wish to testify need to adjust their schedules to meet commitments on the floor.

Mr. SCHULZE. Mr. Chairman, in the interest of time, I wonder if my statement could be placed in the record without taking the time to read it.

Chairman STARK. Without objection, Mr. Schulze's statement will be included in the record.

[The prepared statement of Mr. Schulze follows:]

STATEMENT OF HON. RICHARD T. SCHULZE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman and Members of the Subcommittee, I am pleased that H.R. 2647 has been called up today for a hearing. I believe that my bill addresses an unfortunate inequity in the Internal Revenue Code, and I hope that the Subcommittee will report it favorably.

Under current law, withholding is required on certain gaming winnings. In general, twenty percent withholding is required if the proceeds from a wagering transaction are more than $1,000 and the odds are at least 300 to 1. This rule applies to winnings from a parimutuel pool with respect to horse races, dog races, or jai alai.

On the other hand, withholding is not required on proceeds from a wager placed in a state lottery unless the proceeds exceed $5,000.

Thus, present law discriminates against the parimutuel gaming industry, and in the process causes a depressing effect on the supporting activities such as the concessions at race tracks and the agricultural activities that make horse racing the sport that it is.

The end result is lower income for the industry, reduced employment opportunities, and sharply reduced income to states and localities. The impact cannot be ignored.

H.R. 2647 will correct this inequity by increasing the threshold level for gaming withholding to $5,000 for all subject winnings. This will minimize the depressing effect that withholding has on a legitimate industry that is important to my Congressional District and to the entire country.

Mr. Chairman, the horse industry in America consists of sporting activities and events, and of recreational activities. The horse industry is substantially benefitted from the racing segment which, because it generates substantial revenues, can cover many of the fixed costs associated with horse breeding. Thus, animals raised for recreational or show purposes are beneficiaries of the legitimate horse racing activities in the United States. Further, there are non-quantifiable benefits to the citizens of this country who live in or just pass through the "horse country" where horses are raised. If anyone doubts this, let them visit portions of the 5th Congressional District of Pennsylvania. It is beautiful country and has been preserved partially through horse breeding.

Pennsylvania ranks as one of the preeminent states in terms of the size and importance of its horse racing and breeding industry. It houses two tracks for harness racing (Liberty Bell in Philadelphia and The Meadows, near Pittsburgh), two for throroughbread racing (Keystone, near Philadelphia, and Penn National in the Harrisburg area) and one (Pocono Downs, Wilkes Barre) which in the past offered both types of racing.

Horse breeding spans all districts in the state. The breeding and development of standardbred horses for harness racing dates to the 18th Century and remains a vital Commonwealth business. The state has a developing thoroughbred breeding program, and the breeding segment of the industry as a whole employs a large and skilled work force.

It is important to note that these economic impact estimates do not include intra-industry payments such as purses and sales. Nor do they reflect purchases of breeding stock and horses in train-

The parimutuel race track business is of more recent vintage, but has carved an important niche for itself by virtue of significant direct contributions to the State Treasury.

Through 1977, harness and thoroughbred racing had contributed a total of $378,394,538 to the State Treasury through the parimutuel wagering tax alone. Though impressive, this figure is dwarfed when considering the entire economic contribution to the Commonwealth of the racing and breeding industry. For example, the primary cash flow in the single year 1977 amounted to $155,461,765. I have prepared a table which shows this cash flow in detail:

PRIMARY CASH FLOW TO PENNSYLVANIA ECONOMY FROM RACING, 1977

	Payments By		
Payments To	Thoroughbred Industry	Harness Industry	Totals
Government	$ 22,134,294	$ 16,443,261	$ 38,577,555
Other Industries	34,305,546	24,774,199	59,079,745
Wages and Salaries	35,769,656	22,034,809	57,804,465
Totals	$ 92,209,496	$ 63,252,269	$155,461,765

Allowing for secondary and tertiary multiplier effects as the cash flow moves through the economy, the total impact of the horse racing and breeding industry in Pennsylvania can be conservatively estimated at $300,000,000 in 1977 alone. This figure has clearly grown in more recent years.

It is important to note that these economic impact estimates do not include intra-industry payments such as purses and sales. Nor do they reflect purchases of breeding stock and horses in training which are additional sources of impact.

Direct employment accounted for by the industry in 1977 was 18,552; current state employment estimates range from 25,000-27,000.

Any regressive tax, such as the withholding on legal parimutuel winnings, damages the industry affected. The purpose of H.R. 2647 is to minimize the negative effect on the horse industry.

As a Member of the Ways and Means Committee, I am dedicated to reforming those provisions of the Internal Revenue Code which serve no productive function. Eliminating unnecessary withholding is one important improvement.

I believe that the voters of the United States gave the Congress a mandate to eliminate wasteful regulations and unnecessary administrative burdens of all kinds. Accordingly, the time is ripe for Congress to study the several suggestions for reform proposed today and adopt those measures which represent sound tax policy and promote the economy.

Further, the voters have indicated a preference for less interference by the federal government in local matters. This extends to the area of federal tax impact on state and local revenues. Where the states have created a local economy around legitimate horse-racing activities, it is not appropriate for the federal government to burden these state industries unnecessarily.

Mr. Chairman, raising the threshold level for withholding to $5,000 will eliminate a tremendous paperwork burden on a legitimate industry. It will minimize the depressing effect that the regressive withholding rule has on the horse industry, and the many supporting industries that contribute to its success. And finally, it will eliminate a discriminatory feature of the Internal Revenue Code.

I urge my Colleagues to give H.R. 2647 their full support.

Chairman STARK. I would like to call Mr. Jones of Oklahoma, the author of H.R. 2597.

STATEMENT OF HON. JAMES R. JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. JONES. Thank you, Mr. Chairman. I appreciate this opportunity to appear before the subcommittee.

Basically, as you pointed out, I am testifying on behalf of H.R. 2597, which was introduced by Congressman Conable and myself. This legislation seeks to address a problem which occurs in the operation of two fundamental themes in the history of mankind. One is peace and the other is death. While this may sound overly simple, those two experiences are the sole reasons that we are asking the subcommittee for legislative relief.

In a nutshell, Mr. Chairman, this is the problem. In 1969 Congress added section 501(c)(19) to the Internal Revenue Code. This section granted tax exempt status to certain groups and associations of veterans. In order to qualify for this status, the group must be comprised of 75 percent war veterans and the remaining 25 percent substantially comprised of veterans' widows, military cadets and others associated with the armed services.

The problem is simple. The 75 percent war veterans test is increasingly difficult to achieve since our country has not been involved in any war since the end of the Vietnam conflict. This fact, coupled, with the national attrition rate among war veterans in these groups, is jeopardizing their tax status as the percentage of war veterans dips dangerously close to the 75 percent figure.

If they go below the figure they will lose their tax exempt status and many of the fine programs these groups undertake for veterans will be terminated. So what we are asking is that this section of the code be changed.

The bill would remove the requirement that 501(c)(19) organizations have to be comprised of 75 percent war veterans and instead simply require that 75 percent of the membership would have to be veterans. The test of the remaining 25 percent would remain the same.

We think this will cure the problem. As I understand it, it will not cause any revenue loss. As of last night Treasury did not oppose this legislation. Overnight they changed their position. I understand they have opposition to the legislation and somehow it ties in with their position on raising revenues from the insurance industry through changes in MODCO.

The fact is that the MODCO legislation and the legislation affecting veterans are as different as night and day. They do not complement each other or directly affect each other. Therefore, I really believe that Treasury, on reflection, would find that that is not the case and that there should be no tie-in to the MODCO reforms.

I would hope that the subcommittee would do as I understand it did in the last Congress—give favorable attention to this legislation and move it forward so that these programs could be retained for these veterans.

[The prepared statement follows:]

STATEMENT OF HON. JAMES R. JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. Chairman, Members of the Subcommittee:

I appreciate this opportunity to appear before you to discuss legislation introduced by Congressman Barber Conable and myself, H.R. 2597.

This legislation seeks to address a problem which occurs from the operation of two fundamental themes in the history of mankind; peace and death. While this may sound overly simple, those two experiences are the sole reason that we are asking this Subcommittee for legislative relief.

In a nutshell, Mr. Chairman, this is the problem. In 1969, Congress added Section 501 (c)(19) to the Internal Revenue Code. That section granted tax exempt status to certain groups and associations of veterans. In order to qualify for this status, the group must be comprised of 75% "war veterans", the remaining 25% must be substantially (i.e., 90%) comprised of veteran's widows, military cadets, or others associated with the armed forces.

The problem is simple. This 75% "war veterans" test is increasingly difficult to achieve since our country has not been involved in any war since the end of the Vietnam conflict. This fact, coupled with natural attrition rates among the war veterans in these groups, is jeopardizing their tax status as the percentage of "war veterans" dips dangerously close to the 75% figure. If they go below this figure, they will lose their tax exempt status, and many of the fine programs these groups undertake for veterans will be terminated.

Even now, many of these affected veterans groups are considering barring membership to non "war veterans" so as to prevent their status from being threatened. Such artificial limitations, while understandable, are unfair to those recent members of the armed forces who may be penalized because of the operation of our tax code.

To cure this problem, Congressman Conable and I have drafted H.R. 2597 which is now before your Subcommittee. This bill would remove the requirement that 501(c)(19) organizations have to be comprised of 75% "war veterans", and would instead simply require that 75% of the membership would have to be veterans. The test as to the remaining 25% would remain the same.

Mr. Chairman, we have proposed this solution in anticipation of avoiding some very real problems that are just over the horizon for some of these veterans groups. Since no 501(c)(19) organization has currently slipped below the 75% level, there is no revenue loss associated with the passage of our bill. On the other hand, if the affected organizations lose their tax exempt status due to the operation of this out of date formula, the total revenue intake to the government would be less than $5 million dollars a year, according to the Joint Tax Committee. Clearly, Mr. Chairman, we are talking about small sums of money to the government; but large sums of money to these organizations affected by the operation of the current law.

We feel that our legislation is a fair and equitable answer to the problem. It would preserve that character of these organizations as ones essentially designed to serve veterans. At the same time, it would not penalize them in time of relative peace in the world. I hope the Subcommittee can act favorably on our bill. Thank you.

Chairman **Stark**. Thank you very much, Congressman Jones, for your testimony in support of what I think many of us on the subcommittee feel is a worthy cause.

Mr. Duncan.

Mr. **Duncan**. I have no questions. Thank you.

Chairman **Stark**. Thank you. We appreciate your testimony.

We will at this time continue and finish the testimony on H.R. 2597 with Gen. Russell Dougherty, representing the Air Force Association and Mr. William J. Lehrfeld, counsel for the AMVETS. As they come forward, may I mention that Congressman Daub is on his way to testify.

Good morning, gentlemen. General Dougherty, I am going to ask you if you would like to proceed to summarize your testimony. Your full prepared statement will appear in the record. We welcome you to the committee this morning.

STATEMENT OF GEN. RUSSELL E. DOUGHERTY, USAF (RETIRED), EXECUTIVE DIRECTOR, AIR FORCE ASSOCIATION

General **Dougherty**. Thank you, Chairman Stark. I am Russell Dougherty, executive director of the Air Force Association, and I am accompanied here this morning by our former national president and chairman of the board and now permanent director of our association, Gen. Jess Larsen. Also with me is our tax counsel, Mr. Lyman Friedman from the firm of Williams and Connelly.

We are grateful to you, Chairman Stark, and to your committee for this hearing on H.R. 2597 and to Congressman Jim Jones for his statement and for his sponsorship, along with Congressman Barber Conable and a large group of cosponsors who introduced and supported this needed legislation.

We have submitted our formal statement, Congressman Stark. I will not take your time to repeat that statement other than to say that we are vitally interested in H.R. 2597 and also are associated in this by the Air Force Sergeants Association, the Fleet Reserve Association, the National Guard Association of the United States, the National Association of Uniformed Services, the Reserve Officers Association, the Retired Officers Association, and the AMVETS, who are represented here this morning by my colleague.

We have submitted statements to your committee prior to this hearing. Suffice it to say that the intent of the changes we seek is to eliminate the necessity for a minimum of 75 percent of our members to have served in time of war and to permit all present and past members of the Armed Forces of the United States to count toward this 75 percent veterans membership needed to qualify for continued tax exemption.

We suggest that this be done simply by deleting the word "war" as an adjective describing veterans in section 501(c)(19) of the Code. Frankly, the problem presented is the highly fortunate result of our being at peace throughout the world. Only periods of war can create war veterans. Thus, the present statute prohibits participation by future veterans of the Armed Forces whose military service has been during an absence of war.

I would like to echo what Congressman Jones said. As a recent commander of the Strategic Air Command, I assure you that today's servicemen and women are exposed and required to provide the same dedicated service by people standing alert on air bases throughout the world, as we did during Korea and Vietnam.

We respectfully ask, therefore, that the Congress enact this legislation which will apply the 75 percent requirement for veterans organizations to include past and present members of the Armed Forces.

I heard the opposition expressed by Secretary Chapoton of the Treasury. We were certainly pleased to hear him express sympathetic understanding of our membership dilemma, for the relief we seek is basically a membership problem for us, a problem for which we need relief now. But we were confused and concerned by his expression of the general concern of Treasury due to a general study under way in Treasury of life insurance companies.

We are not a life insurance company, Mr. Chairman. We are a veterans organization and we intend to remain that. We understand that such studies have been under way in Treasury for some years and we urge that our critical membership relief not be set aside for such general opposition; recognizing, of course, that when Treasury completes their general study and when Congress acts upon their recommendations that that will stand on its own merits.

It seems to us that the impact on Treasury of our proposed legislation is, in short, a zero sum game, to use that expression. We either get relief for our membership constraints and extend the professional benefits to other young men and women veterans or, if denied the relief, we stand in place and gradually atrophy and ossify; and we don't want to do that.

We think that the Treasury impact is negligible and we hope that this committee and Congress will not confuse our membership problem as a veterans organization with a general study of life insurance companies under basic law, which is not affected by this amendment we seek.

We are and we will remain, and we must remain, a veterans organization. We are not primarily or secondarily an insurance company and never will be.

Thank you, Mr. Chairman, for the opportunity to appear.

[The prepared statement follows:]

STATEMENT OF GEN. RUSSELL E. DOUGHERTY, USAF (RET), EXECUTIVE DIRECTOR OF THE AIR FORCE ASSOCIATION

Thank you, Mr. Chairman, for arranging this Hearing and inviting us to be here this morning to express our views to you and your committee with respect to H. R. 2597.

First, about the Air Force Association: We have some 158,000 members and 290 chapters throughout the United States and its Territories and Possessions. Our members are citizens of the United States who are now or have been at one time on extended active duty with the Armed Forces of the United States, or who is a spouse, widow or widower of such individual, or who has been a member of the Guard or Reserve of the Armed Forces of the United States.

We are, and I quote from our constitution, "an organization through which free men may unite to fulfill the responsibilities imposed by the impact of aerospace technology on modern society, to support armed strength adequate to maintain the security and peace of the United States and the free world, to educate ourselves and the public at large in the development of adequate aerospace power for the betterment of all mankind, and to help develop friendly relations among free nations based on respect for the principle of freedom and equal rights to all mankind."

When testimony on this legislation was being heard during the Second Session of the last Congress, the then-Department of the Treasury representative expressed minor opposition and incorrectly compared all veterans' organizations with social clubs. The Air Force Association is not now, nor ever has been a social club -- Section 501 (c) (7) of the Code. Prior to the enactment of 501 (c) (19), we were recognized as a welfare organization -- Section 501 (c) (4).

The current provisions of Section 501 (c) (19) of the Internal Revenue Code of 1954 require that, if a veterans' organization is to maintain its tax exempt status, at least seventy-five percent of their members must be "War Veterans". The effect of this is to deny many of our younger, peace-time servicemen and the increasing number of servicewomen the opportunities and benefits of membership in worthwhile veterans' groups. The intent of the changes we ask is to eliminate the necessity for a minimum of seventy-five percent of members to have served in time of "War" and to permit all present and past members of the Armed Forces of the United States to count toward this seventy-five percent veteran membership needed to qualify for certain tax exemptions. We would do this by simply deleting the word "War" as an adjective describing veterans in Section 501 (c) (19).

The problem presented is the result of our being at peace throughout the world. Thank heavens! Only periods of war can create "War" veterans. Thus the present statute inhibits participation by future veterans of the Armed Forces whose military service has been during an absence of war. This, we suggest, is an illogical reason for denying their membership in their own Services' professional veterans' organization. But, if they were to be admitted to such membership under the present statute, the tax-exempt status of the professional organization would immediately be in jeopardy. This proposed legislation would relieve that dilemma.

If relief is not granted, a progressive atrophy will be forced on our Association and the majority of our young men and women that now are serving, or have served since 1975, in the Armed Forces will be denied the personal associations and professional enrichments of membership in these organizations, as well as the practical benefits of such affiliation.

A young man or woman who entered the Armed Forces after May 7, 1975 (the official end-point of the Vietnam conflict, as declared by the Congress) does not qualify as a "War Veteran". If these younger veterans are permitted to join our organization, the percentage of war veterans within our overall membership is diluted on a ratio of three to one; i.e., it takes three war veteran members for each non-war veteran member to satisfy the requirements of the present statute. Over the past few years, this percentage in our Association has fallen from more than ninety-two percent in 1973 to seventy-six percent today. Hence, we face the anomalous situation where we now must exclude from membership in their Service's national professional association young men and women who have voluntarily chosen to serve their country. As a result, the multiple benefits of membership in AFA will be denied these young veterans, should this legislation not be enacted.

These benefits include: professional, educational, and training programs; local and national seminars and symposia on timely topics relating to national security; scholarship supplements and incentives; service-oriented, professional magazine subscriptions; awards and recognition programs for military and civic achievement; regular local meetings and discussions on timely subjects of national security, foreign affairs and specific Air Force interests therein; unrestricted, professional interchanges between enlisted and officer personnel in an Association environment; organized support for service charities, veterans' hospitals, officer and enlisted councils, ROTC. the Air Force Academy, Junior ROTC, Civil Air Patrol and community patriotic programs; finally, low cost, unrestricted health, life and accident insurance; supplemental medical payments associated with the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS).

We believe this to be a most unfortunate and highly discriminatory situation which works against young military people generally and, specifically, against the increasing numbers of highly motivated young men and women joining the Armed Forces voluntarily.

The preservation and fostering of strong peace-time volunteer Armed Forces, composed of young men and women who have not been subjected to a military draft, is quite correctly an item of foremost importance and national concern. Ironically, however, the longer this Nation enjoys a period free from involvement in a military conflict, -- and we hope this circumstance will last forever -- the more likely it becomes that more and more of these peace-time volunteers must, progressively, be refused membership in our and similar veterans' organizations receiving tax-exemption under the provisions of 501 (c) (19) of the Code. Otherwise, the tax-exempt status of such veterans' organizations will have to be forfeited because these peace-time veterans will not be "War Veterans" with the result that the prescribed numerical percentage tests, now a requirement of Section 501 (c) (19) of the Code, will not be satisfied.

Section 512 (a) (3) (B) (ii) of the Code, enacted as part of the Tax Reform Act of 1969, exempts from the unrelated business tax the amounts set aside to provide for the payment of life, sickness, accident or other benefits in the case of voluntary employees' beneficiary associations. Thus, it would seem that the exemption of the insurance activities of veterans' organizations from the unrelated business taxable income provisions is in no meaningful way tied to whether or not military service of association members occurred during a time of military conflict. There appears to be no compelling policy consideration for permitting such benefits to employee beneficiary associations, while denying such benefits to associations of past and present members of the Armed Forces of the United States, based on whether such service was conducted in times of war or peace.

Currently, 501 (c) (19) organizations are exempt from taxes on income other than that which is business related. We foresee no adverse impact on government revenue resulting from our requested legislation; in fact, if we are permitted the option to grow, rather than to atrophy, a reasonable expectation is that our growth will result in increased revenue on our taxable business-related income; e.g., magazine advertising. Thus, passage of H. R. 2597 will have no adverse revenue impact and could have a positive revenue effect. If veterans' organizations retain their tax-exempt status under 501 (c) (19), and progressively age and atrophy, it is likely that they would be forced to suspend many of their activities due to financial considerations. In any event, it appears that the Government would not collect any additional tax by enacting this legislation -- and may well lose revenue if it is not enacted.

Mr. Chairman, we ask respectfully that you and your Subcommittee endorse our request for legislation that would apply the seventy-five percent requirement for membership to include "past and present members of the Armed Forces", without regard to whether such service was in war or peace. The make-up of the other twenty-five percent of membership would continue to include non-veteran cadets or spouses, widows or widowers of past and present members of the Armed Forces.

Mr. Chairman, you were present when we appeared before this Committee two years ago at which time Congressman Rostenkowski was chairing the meeting. At that time, you asked for specific financial figures relating to our activities. We addressed your request as well as answered some specific questions from Chairman Rostenkowski. We have updated this response, Mr. Chairman, and we are pleased to submit this information here for the record.

Again, Mr. Chairman, thank you for this opportunity to appear before your Committee and you today.

I stand ready to respond to any questions you may wish to present to us.

AIR FORCE ASSOCIATION
1750 PENNSYLVANIA AVE., N.W., WASHINGTON, D.C. 20006-4588 (202) 637-3300
An Independent Non Profit Aerospace Organization

RUSSELL E. DOUGHERTY
Executive Director

March 15, 1982

Hon. Fortney H. Stark, Chairman
Subcommittee on Select Revenue Measures
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Chairman Stark:

The Air Force Association, which I represent, is the organization on whose behalf H. R. 2597 was introduced. In reviewing the record of your Subcommittee's hearing on an earlier bill during the 96th Congress, you may recall that then-Chairman Rostenkowski and you, personally, asked for specific financial figures relating to the AFA's activities. In the belief that you and/or your Committee may wish to have updated statistics with respect to the activities of the AFA, we respectfully submit for the record the following data reflecting our 1980/1981 activities (most financial figures shown are audited figures for 1980; 1981 figures are undergoing formal audit at this time):

- Membership: The AFA, as of December 21, 1981, had 157,701 members
- AFA-sponsored insurance:
  - At the end of 1981, 39,736 members held 44,743 certificates of AFA insurance under several plans. Average amount of life insurance carried - $35,400; average amount of accident insurance - $42,000; average coverage under hospital indemnity is $50 daily in hospital benefits. (AFA insurance programs are operated by national headquarters — not by regional, state or local organizations; AFA administers and services its group insurance program which is underwritten by United of Omaha. AFA accident insurance and hospital indemnity -- CHAMPUS and Medical supplement — are underwritten by Mutual of Omaha. Both of our Omaha underwriters are taxable entities.)
  - Average annual gross income to AFA from its three insurance programs, 1977-1980, was $1,620,851. Average annual expense against the insurance program for these three years was $1,543,279; refunds to insurance certificate holders for three-year period averaged $777,533; average annual net income from insurance to the Association during the period '77-80 was $77,572.
  - 1980 premium refund (dividend) to insurance certificate holders - $887,000

- AFA's estimate of new members anticipated as a result of passage of H. R. 2597 — 18,000-20,000 per year for the next 5 years.

- Field service programs -- the following rounded-off amounts were spent during 1980 for services and programs as indicated:

-- Local, state and regional awards, programs, hospital visits, scholarships, etc. - $682,000

-- National security awards - $18,000

-- ROTC support programs and awards - $12,000

-- Junior Officer Council support - $7,000

-- Enlisted Council support - $5,000

-- Arnold Air Society programs and support (cadet society organized among 5,600 ROTC cadets in 139 colleges and universities) - $25,000

-- Outstanding cadet program, Air Force Academy - $12,000

-- Support of Aerospace Education Foundation (501 (c) (3) educational organization) - $50,000

We trust that this data will be of service to you and your Committee. Should you desire any further information we would be pleased to respond upon request.

We take this opportunity again to express our appreciation for your time and consideration of our problem.

Respectfully,

Russell E. Dougherty
General, USAF (Ret.)

Chairman Stark. Thank you, General Dougherty. I would at this time like to call our colleague, the Honorable Hal Daub of Nebraska to testify.

STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. Daub. Mr. Chairman, I appreciate this opportunity to appear. I really do not want to take but a moment of time. I have a statement I would like to have included in the record. I am proud to be a cosponsor.

Chairman Stark. Without objection, your full statement will appear in the record.

[The prepared statement follows:]

STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

MR. CHAIRMAN:

MY CONSTITUENCY IN THE SECOND CONGRESSIONAL DISTRICT OF NEBRASKA INCLUDES A GREAT NUMBER OF ACTIVE DUTY AND RETIRED SERVICEMEN AND WOMEN. ISSUES AFFECTING THEM ARE OF PARTICULAR INTEREST TO ME, AND I THEREFORE APPRECIATE THIS OPPORTUNITY TO TESTIFY IN SUPPORT OF H.R. 2597, LEGISLATION TO AMEND THE INTERNAL REVENUE CODE OF 1954 WITH RESPECT TO THE EXEMPTION FROM TAX OF VETERANS ORGANIZATIONS.

IN VIEW OF THE TIME LAPSE SINCE THE END OF THE VIETNAM CONFLICT AND IN ANTICIPATION OF AN ERA OF PEACE, FEWER AND FEWER VETERANS WILL HAVE SERVED DURING A PERIOD OF WAR. CONSEQUENTLY, MORE AND MORE VETERANS BELONGING TO VETERANS' ORGANIZATION WILL NOT HAVE BEEN IN THE SERVICE DURING A WAR.

THIS FACT JEOPARDIZES THE TAX EXEMPT STATUS OF THOSE VETERANS' ORGANIZATIONS THAT FALL BELOW THE 75% FLOOR REQUIREMENT FOR "WARTIME VETERANS."

THE PURPOSE OF TAX EXEMPT STATUS FOR ORGANIZATIONS IS TO ENHANCE THOSE THAT CONTRIBUTE TO THE PUBLIC GOOD AND THERE IS NO QUESTION THAT OUR NATION'S VETERANS' ORGANIZATIONS MEET THIS GOAL AND ARE DESERVING OF TAX EXEMPT STATUS.

MEMBERS OF THE AIR FORCE ASSOCIATION FROM OMAHA, NEBRASKA, HAVE REQUESTED MY SUPPORT IN THIS MATTER AND I AM HAPPY TO BE A CO-SPONSOR OF H.R. 2597 AND I APPRECIATE THE OPPORTUNITY TO TESTIFY BEFORE YOUR COMMITTEE TODAY.

WITNESS: Hal Daub
TITLE: Member of Congress
ADDRESS: 1008 Longworth Building
FIRM: House of Representatives
PHONE: 225-4155

HEARING: Subcommittee on Select Revenue Measures
BILL: H.R. 2597
DATE: 3/16/82
SUBJECT: Exemption from Tax of Veterans Organizations

TESTIMONY OUTLINE

1. AMEND: (a) paragraph (19) of section 501(c) of the Internal Revenue Code of 1954 from "War Veterans" to "past or present members of the Armed Services...."

   and

   subparagraph (B) to read "(B) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States....."

2. JUSTIFICATION: My constituency, in thd 2nd Congressional District of Nebraska, consists of a great number of active duty and retired servicemen. In anticipation of an era of peace and the time lapse since the end of the Vietnam Conflict, "War" should not be the criteria required to maintain a viable organization. Both the members and the community would benefit from the security of a tax exempt status with less than 75 % of the membership having served in or during wartime.

3. CONCLUSION: Servicemen and service organizations provide important functions to the nation and should not be penalized in times of peace.

Chairman STARK. At this time, Mr. Lehrfeld of the AMVETS, you may proceed.

STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, AMERICAN VETERANS OF WORLD WAR II (AMVETS)

Mr. LEHRFELD. My prepared statement is rendered irrelevant by the Treasury's testimony. I think that I would like to address myself to something that is very misleading in Treasury testimony.

If you, Mr. Chairman, buy some life insurance and at the end of the year receive a rebate from John Hancock you are not required to report that as income. That has been the principle of the tax law since 1932 in a decision by the Internal Revenue Service in G.C.M. 10792.

Chairman STARK. You are referring to dividends?

Mr. LEHRFELD. I am referring to insurance dividends. When our veterans organization permits John Hancock to solicit under our name for life insurance or health insurance coverage and we agree to accept a premium rebate for our endorsement of their policy, we are not receiving actually any income of any sort that the Congress sought to tax in 1950 or the Congress sought to tax in 1969.

We are receiving rebates, excess premiums amounts that have been paid by the carrier directly to finance regular membership activities. There is a substantial question whether this type of income would ever be considered income subject to the unrelated business income tax.

If you buy insurance from Blue Cross or Blue Shield, health insurance, you are buying it from a tax-exempt organization. However, some commercial life insurance companies and some commercial carriers of health insurance will not sell their insurance to veterans because veterans have disabilities and certain disabilities require higher premium payments. If a veterans organization can offer insurance coverage to every member on a group basis, regardless of their disabilities, which arose through their service, for example, and they are enhancing, in fact, the interests of the United States.

Finally, as to the study of life insurance, I would like to point out to the chairman that in 1964 the Internal Revenue Service began a study of the term "accident insurance" for fraternal benefit societies. Now, some 18 years later, that study is still going on and it is reported as such in the Internal Revenue Service Exempt Organizations handbook.

I would think that it is not the wisdom of the Congress to let the Internal Revenue Service dictate what is today rather sound tax policy in permitting the liberalization of this exemption provision and I would like, if the record could be held open briefly, I would like to submit a more detailed statement on the treatment of insurance organizations and Internal Revenue Service studies.

Thank you, Mr. Chairman.

Chairman STARK. Thank you, Mr. Lehrfeld. I would appreciate that.

[The prepared statement follows:]

STATEMENT OF AMVETS, AMERICAN VETERANS OF WORLD WAR II, KOREA AND VIET NAM, SUBMITTED BY WILLIAM J. LEHRFELD, ESQ.

A. Introduction

The purpose of this communication is to set out, for the record, the position of AMVETS, American Veterans of World War II, Korea and Viet Nam, on H.R. 2597, which amends Section 501(c)(19) of the Internal Revenue Code. Section 501(c)(19) of the Code was enacted to preserve and protect certain revenues derived by veterans' organizations from insurance programs which are offered to their members, spouses, or designated beneficiaries. If a veterans organization described in Section 501(c)(19) sets aside the income from its insurance activities for charitable and similar purposes described in Section 170(c)(4), the amounts are not subject to income tax. H.R. 2597 would liberalize the current description of veterans' organizations contained in Section 501(c)(19) making that provision less restrictive than it is thereby enabling veterans' organizations to protect, as tax free, income from its insurance programs.

B. Purposes of AMVETS

AMVETS was originally organized under an Act of Congress (Public Law 216, 80th Congress) for the support and benefit of veterans of World War II. Its membership is now open to veterans of Korea and Viet Nam. AMVETS basic purposes are (1) to preserve for ourselves and our posterity the great and basic truths and enduring principles upon which this

Nation was founded; (2) to maintain a continuing interest in the welfare and rehabilitation of disabled veterans and to establish facilities for the assistance of all veterans and to represent them in their claims before the Veterans Administration and other organizations without charge; (3) to dedicate ourselves to the service and best interests of the community, State and Nation, to the end that our country shall be and remain forever a whole, strong, and free Nation; (4) to aid and encourage the abolition of prejudice, ignorance, and disease, and to encourage universal exercise of the voting franchise, to the end that there shall be elected and maintained in public office men and women who hold such office as a public trust administered in the best interests of all the people; (5) to advocate the development and means by which all Americans may become enlightened and informed citizens and thus participate fully in the functions of our democracy; (6) to encourage and support an international organization of all peace loving nations, to the end that not again shall any nation be permitted to breach their national peace; (7) to continue to serve the best interests of our Nation in peace and in war.

These noble principles are still carried out in the various activities of AMVETS by its membership. AMVETS appears today because it is very concerned about the privileges and immunities contained in the Internal Revenue

Code relating to veterans' organizations. Among the benefits accorded veterans organizations are the allowance of contributions and gifts to be deductible for federal income, estate and gift tax purposes. See, Sections 170(c)(3), 2055(a)(4) and 2522(a)(4) of the Internal Revenue Code. A veterans organization's ordinary earnings are exempt from federal income tax (IRC Section 501(c)(4)) and although subject to the unrelated business income tax, Section 501(c)(19) protects certain insurance income derived from its members when set aside for charitable purposes.

C. Support for H.R. 2597 and Suggested Improvements

We support enactment of H.R. 2597, and its liberalized treatment of certain veterans organizations' earnings. However, we believe that the bill could serve as an appropriate vehicle for the technical revision of Section 170(c)(3), Section 501(c)(19), Section 2055(a)(4) and Section 2522(a)(4) to assure identical treatment for all purposes for all veterans organizations and auxiliaries. Each of the aforecited statutes deal with the income tax exemption or charitable contribution deduction status of veterans organizations. Yet, despite that common purpose, not one of the Code provisions cited above is identical to any other Code provision. It seems odd to us that contributions to veterans organizations for income, estate and gift tax purposes are deductible as charitable contributions yet the statutory provisions dealing with the description of the type of veterans organization contain many vagaries. Attached to this testimony is a listing of 14 characteristics found in the four Code provisions in question and you can see the inconsistencies. In our opinion, the absence of identical provisions can only breed questions concerning exclusions from any one or more of them and possibly, as a consequence, hamper the ability of veterans organizations to carry out their charitable, patriotic and civic purposes. Sound tax policy suggests there should be a single description of veterans organizations covering all four provisions such as:

> "An organization of veterans, or an auxiliary unit, organized in the United States or any of its possessions, no part of the net earnings of which inures to the benefit of any private individual."

If the four provisions now contained in the Code were repealed, and the following statute substituted, it would probably be of great assistance in the administration of the internal revenue laws and eliminate many questions that arise because of the haphazard drafting of each of the four statutes.

D. Intention of Congress in the Technical Correction

We believe the following points should be made with respect to the proposed statute and some other considerations which the Congress may wish to consider dealing with the scope of our proposed new statute.

1. We do not believe that the exemption should be for "war veterans" organizations. Our organization, and I'm sure all other veterans organizations, are dedicated in part to a course of conduct which assures us that America will never again be at war. If America never does again go to war, gradually all of these veterans organizations of men and women who have served in the armed forces or in the uniformed services, will lose their tax exempt status under Section 501(c)(19) and their tax deductible status because persons who served during the time of any war will have died.*/ New members would simply be "veterans" of any number years of service in the armed forces, but who did not during the course of that service, serve in any "war". The term "war"

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*/ Sec. 501(c)(19) is a cumulative exemption provision in that Sec. 501(c)(4) also exempts veterans organizations as social welfare organizations (without regard to the "war" condition). See, e.g., Rev. Rul. 68-455; Rev. Rul. 68-45; Rev. Rul. 66-150; Rev. Rul. 58-517; Rev. Rul. 55-156; I.T. 2460; O.D. 439.

veterans" should be eliminated from the law and the term "veterans" substituted. This is now the case for deductibility of contributions under the federal estate tax law.

2. The Congress should consider whether or not the term "veteran" should include individuals who are veterans of the uniformed services of the United States which are not the armed forces of the United States. In this regard, I call to your attention that the United States Public Health Service is a uniformed service of the United States, but is not, to my knowledge, part of the "armed forces".

3. It is our belief that the legislative history should clearly state that the term "veterans organization" includes an organization which permits an individual to be a voting member of the individual is currently in the active service of the United States or in reserve status. A veterans organization should not be limited to an organization where the individuals have terminated all relationships with the armed forces.

4. The legislative history should make clear that a veterans organization which extends special membership status to cadets, spouses, widows, or widowers of veterans, will not adversely affect its exempt status.

5. The legislative history should also make it clear that merely because the term post(s), society, trust, foundation, local chapters or departments are not mentioned

in the proposed new law, it does not mean that those descriptions of auxiliary or subordinate organizations are not embraced within the term either veterans organization or auxiliary unit. The proposed new statute advocated by AMVETS is merely to clarify existing law by omitting extraneous descriptions of subordinate, related or auxiliary organizations. The term "organization of veterans" is meant to include both a central organization and all subordinate organizations so that a national veterans organization will continue to be eligible to receive a group ruling with respect to its status under either Section 501(c)(4) of the Internal Revenue Code or under Section 501(c)(19) for itself and any subordinate units consistent with the provisions of Revenue Procedure 80-27, C.B. 1980-1, 677.

6. The inurement clause in our proposed legislation deletes the term "private shareholder" and bars exemption to a veterans organization which has any net earnings inuring to the benefit of a "private individual". We do not believe that the term shareholder is an appropriate one in this day and age in light of the fact that, to our knowledge, no veterans organization has "shareholders" and all are either organized under the not for profit corporation laws, or under an Act of Congress as a not for profit corporation. To include the term "shareholder" in the inurement clause suggests or encourages the possibility that a stock corporation could be

organized as a veterans organization and exempt status gained because the statute contemplates there being a "shareholder" in the framework of the organization. By deleting the term, it is clear that there can be no shareholders in a veterans organization.

7. In repealing Section 501(c)(19)(B), we do not believe any federal tax policy is misserved. It is our opinion that this provision was added to the Code by an exuberant staff who did not think through all of the complications and problems which arise in the course of the administration of a veterans organization. If the organization is an organization of veterans of the armed forces, and where it has special classes of members for people who are related to such veterans, or their spouses or dependents, that, realistically, is adequate for the exemption to be applied. We do not know what useful purpose, except for the simple joys of complexity, is served by Section 501(c)(19)(B) in the first place. In the second place, it acts as an unnatural deterrent to the opportunities of veterans organizations to obtain the insurance tax exemption.

8. The Committee report should make it clear that approval of H.R. 2597 does not carry with it the approval of Treasury regulations defining the terms and conditions under which the Internal Revenue Service administers Sections 501(c)(19) or 512(a)(4). We believe a substantial

part of the regulations overreach and have no basis in law. A Committee disclaimer that the proposed is not meant as a direct or implicit approval of any language of the regulations. This could be done by a simple statement saying that the only issue facing the Committee in H.R. 2597 is deletion of the "war" condition for a Section 501(c)(19) recognition of exemption.

End

Legislative Descriptions of
Veterans Organizations

Descriptive Term	Section 170(c)(3)	Section 501(c)(19)	Section 2055(a)(4)	Section 2522(a)(4)
1. Post(s)	Yes	Yes	Yes	Yes
2. Organization	Yes	Yes	Yes	Yes
3. Auxiliary Unit	Yes	Yes	No	Yes
4. Society	Yes	Yes	No	Yes
5. Trust	Yes	Yes	No	No
6. Foundation	Yes	Yes	No	No
7. Local Chapters	No	No	Yes	No
8. Departments	No	No	Yes	No
9. War Veterans	Yes	Yes	No	Yes
10. Veterans	No	No	Yes	No
11. Org. in U.S. or possessions	Yes	Yes	No	Yes
12. Incorp. under Act of Congress	No	No	Yes	No
13. No part of net earnings inures	Yes	Yes	Yes	Yes
14. 75% are war veterans	No	Yes	No	No

Chairman Stark. I think you get on a little thin ice if, as I understand what you are saying, that AMVETS in effect is either providing the membership list and/or directly soliciting and the insurance contract is provided by a mutual insurer. That same premium would pay an agent's commission and I find it a little bit troublesome.

Mr. Lehrfeld. You cannot pay a commission to somebody who is not licensed to sell insurance, and veterans organizations are not licensed to sell insurance.

Chairman Stark. Well, I would like to tell you about the number of ways that that is circumvented and, as a practical matter, in most group policies fees are paid, whether it is to banks who supply their depositor or their borrower lists to organization or to savings or loans who provide their borrowers to companies which have made a lot of money selling mortgage cancellation insurance.

I find nothing wrong with that. I am just saying that I have a problem with the idea that it ought to be tax-free because it is a rebate of a premium paid. I think you might suddenly find Sears, Roebuck having a lot of tax-free income because of its premiums paid by taxpayers and I don't want to have to follow that road all the way to the end. It is only my admonition.

I am sympathetic. I also would appreciate getting your numbers. I have received from General Dougherty some figures about the number of members and the average size of policy and income and expenses, and it will be, I think, very helpful as we pursue this legislation.

I wanted to ask General Dougherty. If I understand your figures correctly, and you are talking about an average gross income of $1,620,000, in the figures you submitted to me, and an average annual expense of $1,543,000. You are also talking about an average refund or what I would call a mutual dividend of around $777,000 and a net income of $77,000.

General Dougherty. That is correct for our audited figures of 3 years.

Chairman Stark. I cannot quite get that to balance. Was the $777,000 added on top of the gross income and then rebated to get a net figure of $1,620,000? Would that be a way for me to understand it in round figures?

General Dougherty. Yes, sir. I think that is right.

Chairman Stark. Your gross receipts were about $2,300,000 or $2,400,000. You rebated $777,000 in effect in refunds or dividends. Your expenses were $1,500,000 and you came out, on an average, with an average net income in that period of around $77,000.

General Dougherty. Yes, sir.

Chairman Stark. Just so I understand how those numbers add up.

I might add for my colleagues that there is a list on page 2 of General Dougherty's letter, which will be made part of the record, which indicates the various awards and scholarship type activity that their association undertakes.

Mr. Duncan.

Mr. Duncan. Thank you, Mr. Chairman.

General Dougherty, do you know any veterans organizations that have had their tax exempt status questioned by the IRS because of the 75-percent war veterans requirement?

General DOUGHERTY. I can't speak for others, sir, but we have not been, because we have very carefully maintained our membership above that 75 percent. Therein lies part of our problem, Congressman Duncan. We have gotten to the point now where we are at 76 percent. We have dropped dramatically over the past few years from a much higher percentage.

Mr. DUNCAN. I tend to support your request. It concerns me, though, as to what the problem is. Do you know of any other veterans organizations that may be having difficulty with the 75 percent rule?

General DOUGHERTY. I can't speak specifically to that, sir. We have talked with all of the veterans organizations about it.

Mr. DUNCAN. Have you heard of any organizations having problems?

General DOUGHERTY. No, sir, I have not heard specifics. I have heard that they have generally associated themselves with us because of the similar concern.

Mr. DUNCAN. What percent of your revenue comes from outside activities, for example, your insurance?

General DOUGHERTY. We publish a magazine, sir, and we take advertising for that and we pay tax on that. It is a professional magazine, but we do take commercial advertising and we have over the years paid tax on that.

We get a substantial portion of our revenue from membership fees—annual membership fees. We conduct seminars. Most of them break even, but occasionally we will have one that will make some money that goes into our general fund and is used for the purposes of the association.

Mr. DUNCAN. How many members do you have?

General DOUGHERTY. We have 157,701, sir, as of December 1981.

Mr. DUNCAN. About what percentage of those participates in the insurance program?

General DOUGHERTY. At that same year end, 1981, we had 39,000 of those 157,000 participating in the insurance program. Some of them had more than one type of certificate. We had 44,743 certificates under several plans.

Mr. DUNCAN. Then the insurance company, how do they rebate or how do they pay you?

General DOUGHERTY. Our underwriter is Mutual of Omaha and United of Omaha. These are taxable entities, so they underwrite our programs.

Mr. DUNCAN. How do they pay you? How do they pay for the benefits?

General DOUGHERTY. They pay the claims directly to the certificate holders.

Mr. DUNCAN. They pay something to the organization.

General DOUGHERTY. Oh, yes, sir. We administer the insurance program out of our national headquarters.

Mr. DUNCAN. Yes, sir.

General DOUGHERTY. The payments are paid in to us and we pay them over to our underwriter.

Mr. **Duncan**. Depending on the volume or per case?

General **Dougherty**. It is a combination of volume of certificate holders and claims against those.

Mr. **Duncan**. Has that developed into being the biggest source of revenue, including membership dues, that you have?

General **Dougherty**. Sir, I would say that it, the membership and the magazine are the major sources of income.

Mr. **Duncan**. I do want to thank you for your very enlightening testimony.

General **Dougherty**. Thank you, sir.

Mr. **Moore**. Mr. Chairman.

Chairman **Stark**. Mr. Moore.

Mr. **Moore**. Gentlemen, I would like to follow up the same line of questioning as the gentleman from Tennessee. What would happen if the Federal Government decided to tax the revenues you receive from the writing or sponsoring of these insurance policies?

General **Dougherty**. It would have a very dramatic effect on us, Congressman Moore. We are small enough that that impact would be rather dramatic. We would just have to do something else.

I am not sure that we would be able to compensate for it without a major revision of our whole structure and how we do things and what we are able to do.

Mr. **Moore**. What percent of your revenue is attributable to the premiums for the policies that you sponsor?

General **Dougherty**. I will have to submit you a specific percentage for the record, sir. I would say that it and the magazine are about 50 percent.

Mr. **Moore**. Half the revenues of your organization comes from that?

General **Dougherty**. Sir, we will have to submit that specifically for the record.

Mr. **Moore**. Mr. Chairman, I ask that the record be left open so we can receive that information. Also, I would like to ask you to see if you can make a computation for us of what your tax liability would be if you are taxed on that.

General **Dougherty**. We have roughed that out and I will submit that, Mr. Moore, at the same time.

Mr. **Moore**. I appreciate that. Thank you, Mr. Chairman.

Chairman **Stark**. Thank you gentlemen very much.

Your full statements will appear in the record and I appreciate your being here.

General **Dougherty**. Thank you, Mr. Chairman, we are grateful.

[The following was subsequently received:]

AIR FORCE ASSOCIATION
1750 PENNSYLVANIA AVE., N.W., WASHINGTON, D.C. 20006 (202) 637-3300
An Independent Non Profit Aerospace Organization

RUSSELL E. DOUGHERTY
Executive Director

March 22, 1982

TO: Mr. John J. Salmon
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Washington, D. C. 20515

SUBJECT: Testimony of General Russell E. Dougherty, USAF(Ret), before the Subcommittee on Select Reserve Measures, of the Committee on Ways and Means, U.S. House of Representatives, March 16, 1982

In addition to minor changes made in the interest of clarity and accuracy, as indicated in pencilled notations on the attached copy of the hearing transcript, the following answers are provided for the record, as requested (and promised) during the hearing:

a. Page 83, Line 1936, et seq. (In response to Mr. Moore's question as to what percent of Air Force Association's revenue comes as profit on the premiums for the insurance policies AFA sponsors)

Answer for the Record: "Congressman Moore, our average gross income over the three most recent audited years, 1978-1980, was \$5,548,765; of that, an average of \$1,620,851 resulted from insurance policies we sponsored. Therefore, sir, the average percent of our gross income attributable to our insurance programs was 29.2%. Over these same three years, our average net income was \$369,666 and our net income from insurance programs was \$77,572; or, a net income percentage of 21% from our insurance program."

b. Page 84, line 1947, et seq. (In response to Mr. Moore's question as to what Air Force Association's tax liability would be if we were taxed on the net income of our insurance programs)

Answer for the Record: "Congressman Moore, had we been taxed at the prevailing rate of taxation for the years 1978-1980 our tax bill on this income for the three year period would have been \$108,000; an average of \$36,225 per year."

We appreciate your courtesy and cooperation in making available copies of the initial transcript so promptly and in enabling our answers "for the record" to be submitted in a timely manner.

RUSSELL E. DOUGHERTY
General, USAF(Ret)
Executive Director

1 Attachment
Transcript of Testimony,
dated 16 March 1982

Chairman STARK. At this point I would like to ask if Mr. Lester Sumner is with us. We will call you to testify at this time, Mr. Sumner.

Mr. Sumner is the senior products manager, Anheuser-Busch Co. Mr. Sumner, welcome to the committee. Your prepared statement will appear in its entirety in the record and I would ask if you would like to identify the gentleman accompanying you and if you would like to proceed to summarize or add additional testimony as you see fit.

STATEMENT OF LESTER F. SUMNER, SENIOR PRODUCT MANAGER, NEW PRODUCTS, ANHEUSER-BUSCH, INC.

Mr. SUMNER. Thank you very much, Mr. Chairman. The gentleman with me is Dick Riddell, counsel for the United States Brewers Association. I like to make some additional comments to my testimony.

The importation of malt beverages in bulk does not enjoy the same treatment that is inferred, the imposition of excise taxes, granted under the law to the importation of distilled spirits. This disparity exists because the current regulations concerning importing malt beverages was originally drafted when there was no reason to include malt beverages, inasmuch as no one then was importing beer in bulk in any significant quantities.

I would also like to address the Treasury Department's statements earlier that one of the reasons they have opposed this bill is that beer brought in in bulk could be stored indefinitely and thus defer the excise tax treatment. This is not true. Beer is a perishable commodity. There is no technology today that can stop beer from being perishable once it is in fact brewed. A lengthy holding time would defeat the reason for importing beer in bulk, and that is to offer the fresh beer to the American consumer.

Mr. Rex Davis, who is president of the National Association of Beverage Importers, strongly supports the enactment of H.R. 1808. Mr. Davis states that the NAB prime membership comprises 125 companies engaged in the importation of wine, spirits, and beer in the United States. Our malt beverage division has 22 firms which import beer into this country. We take notice of the fact that the tax determination on distilled spirits imported into the United States in bulk containers is not made until the spirits are bottled and removed.

We believe it would be in the interest of public equity if similar treatment were accorded to beer imported in bulk containers. He urges our support of the legislation.

The rationale, as stated by Mr. Davis and myself earlier, is to insure equal treatment of the law both for importers of malt beverage, importers of distilled spirits, and to alleviate a bureaucratic function that is both unnecessary and very complicated.

This bureaucratic function places severe limitations on abilities of importers of bulk beverages to move beer from plant to plant or to store the beer for short periods of time. Elimination of this bureaucratic function will eventually increase union jobs by facilitating the bottling procedures in Newark and our ability to move the beer from plant to plant.

If Wurzburger Hofbrau, which is the first beer that is being brought to the country in bulk, can achieve a volume that would support additional ocean shipping tanks, there is consideration of exporting domestic brands in bulk to Europe that will maximize effectiveness of the tanks. They presently go back empty. This would help the country's balance of trade with those countries currently not employing nontariff trade barriers.

I would like to briefly summarize the bureaucratic procedures that I have alluded to. Once the beer in bulk is offloaded in Port Elizabeth, it is in 5,000-gallon containers. At this time we pay Customs duties and our excise tax. Before we can drive the beer to our brewery, special areas of the brewery that the container truck would have to drive over have to be declared off-bond in order to comply with current BATF regulations.

Holding tanks in two floors of our beer storage area in the Newark brewery have already been designated off-bond permanently. We cannot use these areas for any other domestically-brewed beer. The beer is pumped into holding tanks and allowed to settle before bottling.

During this 2-to-3 day period we have to submit paperwork by the assistant manager of the brewery which is a request for release from bond in premise. This now takes 2 working days to approve an allocation, so we have to closely monitor our shipping schedule.

The bottling line and portions of our warehouse have to be declared off-bond for bottling of Wurzburger for periods of up to 48 hours. The areas which are declared off-bond have been circled with yellow lines and the beer has to stay within the yellow lines. These include paths for the forklifts and a special loading dock.

Wurzburger Hofbrau cannot be shipped inner-brewery because we have to load from a special door. We have to ship all the beer in separate containers, separate trucks. As a result, we have a tremendous transportation cost for this.

In summary, H.R. 1808 will benefit the entire brewing industry in that all those importing beer in bulk will be able to do so under the same conditions as importers of distilled spirits. The major intent of this resolution is to clear up unnecessary logistical and bureaucratic functions.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF LESTER F. SUMNER, SENIOR PRODUCT MANAGER, NEW PRODUCTS, ANHEUSER-BUSCH, INC.

H.R. 1808

I. OVERVIEW

The importation of malt beverages in bulk does not enjoy the same treatment (deferred imposition of custom duties) granted under 26 U.S.C. Section 5234 to the importation of distilled spirits. This disparity exists simply because the current regulations concerning importing malt beverages were originally drafted at a time when there was no reason to include malt beverages (beer), inasmuch as no one was then importing beer in bulk in any significant quantities.

II. H.R. 1808

The resolution calls for the addition of Section 5418 to the Internal Revenue code of 1954, which would read as follows:

Section 5418 - Imported Beer

a. Transfer to brewery without payment of tax - Beer imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers or by pipeline to a brewery without payment of the Internal Revenue tax imposed upon such beer. The person operating the brewery to which such beer is transferred shall become liable for the tax on beer withdrawn from customs custody under this section upon release of the beer from customs custody, and the importer, or the person bringing such beer into the United States, shall therefore be relieved of his liabilities for such tax.

b. Withdrawals, etc. - Beer transferred pursuant to subsection (a) may be withdrawn for any purpose authorized by this chapter, in the same manner as domestic beer.

This is much the same wording as U.S.C. Section 5232 with the exception of the use of "beer" and "brewery" rather than "distilled spirits" or "bonded premises of a distilled spirits plant."

Also, paragraph (2) of Section 5054 (a) of such code (relating to determination of collection of tax of beer imported into the United States) would be amended to read as follows:

(2) Beer imported into the United States - Except as provided in paragraph (4), the tax imposed by Section 5051 on beer imported into the United States and on beer removed from customs custody under Section 5418 shall be determined at the time it is removed for consumption or sale, and shall be paid in accordance with Section 5061 by the brewer thereof (or in the case of beer so removed from customs custody, the person liable for such tax under Section 5418).

III. RATIONALE FOR THE ADDITION OF SECTION 5418 AND AMENDMENT TO 5054 (A)(2)

1. To assure equal treatment from the law for both brewers and bottlers of distilled spirits.
2. To alleviate a bureaucratic function that is both unnecessary and complicated (see Para IV below).

3. The bureaucratic function places severe limitations on our ability to move the beer plant to plant and to store the beer once it enters different plants. For instance, unless a special "Consent to Surety" form is filed and approved, A-B cannot even bring the beer into a brewery. This is currently the case in six of our nine breweries: Fairfield, Ca.; Houston, Tex.; St. Louis, Mo.; Jacksonville, Fla.; Tampa, Fla.; and Columbus, Ohio (draught only). In the case of the Columbus, Ohio brewery, additional problems are created because the areas declared "off bonded premise" must be used for Wurzburger cooperage which are different than the ones used in the Columbus shipping pattern, effectively reducing the brewery's draught beer capability.
4. If Wurzburger Hofbrau volume can achieve a volume that would support additional ocean shipping tanks, A-B will consider exporting our domestic brands in bulk to Europe to maximize effectiveness of the tanks (they go back empty now). This would help the country's balance of trade.
5. At the present time, Anheuser-Busch pays tax on all beer at the point of importation and does not get reimbursed for spillage during packaging or beer used in testing. This is approximately 10% of the beer imported.
6. Because Anheuser-Busch uses code dates, there are times when the beer reaching our wholesaler is over age and must be dumped or destroyed. When this happens with our normal domestic beers, we simply file for reimbursement of tax from the BATF. In the case of Wurzburger, we must file for reimbursement from the Customs Department, and we have had considerable difficulty in obtaining timely reimbursement.

7. The Bureau of Alcohol, Tobacco and Firearms, in discussions with our Revenue Department, is in agreement with our request, as it is a paperwork and manpower problem for both of us.

IV. PROCEDURES NOW REQUIRED

1. Filing of blueprints to designate those areas to be placed "off bonded premises" when packaging draught only, bottle only or draught and bottle (simultaneously).
2. Filing of 27-C to match the blueprints.
3. Filing of the Consent Surety which details the altering of terms of the brewers bond. This:
    - a. Covers the repeated extension and curtailment of the brewery for purposes of creating tax paid packaging facilities to cover the installation and use of the tax paid beer lines for transfer of beer from the tax paid storage room across brewery premises to the bottling and racking units.
    - b. Cover the transfer of beer by fork lift truck across unbonded area of warehouse during curtailed operations.
    - c. Cover the transport of tax paid beer to the brewery laboratories for analysis.
    - d. Cover the transfer of tax paid beer by fork lift truck or otherwise across bonded areas of the bottling house and warehouse during curtailed operations.
    - e. Cover the transfer of tax paid beer across bonded premises for purposes of loading delivery trucks.

f. Cover the transfer of tax paid beer, and delivery trucks, across bonded premises (outdoors) enroute to leaving the brewery.

g. Cover the transportation of loaded route trucks which temporarily leave the brewery premises enroute to their overnight parking area located on brewery premises. The entire activity takes place within the fenced-in confines of the brewery property and is under 24 hour guard service.

h. Cover the transfer of kegged beer across unbonded area (tax paid draught storage room) during curtailed and regular operations.

As you can see by the above-mentioned details, the entire situation is time consuming and expensive in terms of man hours used to generate the paperwork. A further problem is incurred in that Wurzburger is usually packaged on weekends, and during the time that the request for the 27C is in effect, the areas disignated as removed from bonded premises cannot be used to package other beers. This means that if the brewmaster wanted to use the Wurzburger packaging line which is also used to bottle Budweiser quart bottles, he could not do so until the following Monday when BATF offices open and a representative authorizes the curtailment of the operation by putting the packaging line on bond.

Any time another brewery is considered as an expansion area (even just for storage and shipping), an exhaustive research project is undertaken to study the off/on bonded situation, i.e., if the storage area for Wurzburger won't be needed to store tax paid beer at some time, or if the cooler space can be spared for draught storage.

V. CONCLUSIONS

1. H. R. 1808 will benefit the entire brewery industry in that all brewers importing beer in bulk will be able to do so under the same conditions as importers of distilled spirits.
2. The situation as it exists now is time-consuming, costs a great deal of money, and to date has impaired the national rollout and further expansion of the brand.
3. Successful development of the Wurzburger brand will enable us to consider using the bulk beer tanks for the exportation of domestic brands to Europe.

Chairman **Stark**. Thank you very much. Mr. Sumner, I am now privileged to call upon your Congressman, Congressman Richard Gephardt, who has introduced this legislation.

Dick, you may proceed as you see fit.

STATEMENT OF HON. RICHARD GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. **Gephardt**. Thank you very much, Mr. Chairman. I thank the members of the committee for allowing the bill to be considered and for having this hearing today.

I believe that the merits of this matter have been well outlined for you. It seems to me that what we have tried to do in this legislation is solve the complication that has been caused in Anheuser-Busch by trying to innovate and bring a product into this country in a new way and to allow them to do that in a competitive way and in a reasonable way.

Obviously major problems come from the complications of dealing with all of their other lines of product which are domestically produced and then this line of product which has come here in bulk. There may be some other way to solve this problem that we could not figure out, but in looking at all the facts we came to the conclusion that the only way to address the problem simply and easily was to impose the excise tax on this product in the same way and at the same time that the excise tax is imposed on their domestically producted products on the sites where all of those products are dealt with.

I realize that this might create some competitive disadvantage with products that are imported in the bottle where the excise tax is imposed as those come into the country. That clearly is not in our minds and is not something we want to do.

It seems to me that there has got to be an answer to this problem. Anheuser-Busch is being, I think, very innovative in trying to bring a product in in this form. No one else has ever done this. It creates the opportunity to hopefully send these barrels back to Germany with domestically produced product, something that they very much want to do.

I think that is in the interest of our export policy and creates a market for those people in America who want to taste German beer and those people in Germany who want to drink American beer.

So for all of these reasons, I think their request is a reasonable one and I just ask the committee to give this full consideration and I would be available to entertain or listen to any ideas that anyone could put forth that would create a solution to this problem.

Chairman **Stark**. Let me, along that line, try this and perhaps Mr. Sumner could respond.

It is my understanding that if you import Heineken that you pay the customs duty and the excise tax when you bring it off the boat.

Mr. **Sumner**. That is correct.

Chairman **Stark**. And you must do the same thing with your 5,000-gallon tanks.

Mr. **Sumner**. That is correct.

Chairman Stark. The competitive advantage might occur in your in effect being able to postpone paying that tax. How long can you keep the beer in the tanks before it gets skunky?

Mr. Sumner. We can keep it for possibly 1 to 1½ weeks. That is the maximum.

Chairman Stark. I mean, if you keep it in the tank 30 days are you in trouble?

Mr. Sumner. We have something that we wouldn't sell.

Chairman Stark. I could suggest this, and if the Treasury would go along, it might be a way. It would seem to me not very hard to calculate a maximum time. Say 30 days—if you pay the bottle duty when it hits the dock and you want to let Anheuser-Busch pay their subsequently bottled product the same way they would domestic beer, which is when it leaves your warehouse, is that correct?

Mr. Sumner. That is correct.

Chairman Stark. You calculate some different tax. You do that now I am sure. I used to work in a brewery a long time ago and we had different tax problems for different States that had different labels.

And let's assume that your postponing this tax for 30 days or 60 days or whatever and merely have them pay a somewhat higher excise tax when it leaves their warehouse. This does not give them a competitive edge, but it might take care of the redtape. Now I am not suggesting that as an alternative bill, but if that is what the gentleman from Missouri had in mind as a way of working this out, I am sure we could find a way.

I think, if I can also anticipate, Mr. Sumner's counsel might like to add a comment to that. We welcome you.

STATEMENT OF JAMES W. RIDDELL, COUNSEL, UNITED STATES BREWERS ASSOCIATION

Mr. Riddell. Thank you very much for the opportunity to comment on behalf of the United States Brewers Association, which represents virtually all of the beer manufactured and sold in the United States.

The principal reason for the legislation comes about by virtue of the fact that those provisions of the Internal Revenue Code which govern the importation and indeed the entire FAA Act as well have not been reviewed and recodified in years.

The practical problems confronting Anheuser-Busch and any other brewer who wishes to get aboard of the swell of foreign imports into this country is simply the fact that they are trying to open up, indirectly, a market abroad. For Anheuser-Busch, Pabst, or Schiltz to be able to import in bulk and then ship abroad would open up for the first time to us foreign markets. That is our principal interest.

Nontariff barriers concerning container size and everything else today is putting U.S. brewers at a gross disadvantage when it comes to exporting their products. Practically speaking, the Treasury Department has not analyzed the case at all. If it were so, then the other members of the National Association of Beverage Importers would be free to point that out instead of addressing a letter to

BATF, instead of to the Treasury Department, as they felt necessary, stating their full support of the bill.

Practically, the problem for AB comes about as it would for Schlitz or Pabst or anybody else who is trying to get on the golden road. The greatest increase, Mr. Chairman, in beer sales in the United States is from imports. It comes about because of the restrictions on the handling of the beer and the fact that the Federal excise tax must be paid on spilt beer.

In other words, if they import 1 million barrels of beer, they are going to lose 100,000 in bottling. That is $9 a barrel or $90,000. The additional transportation costs also very, very bad. A barrel of Wurzburger through the bottling process has cost AB $129; $9 a barrel is roughly 7 percent of that total sum. To imagine that a brewer that has got $129 invested in a barrel of beer is going to hold that beer to avoid paying a $9 excise tax for some fanciful competitive advantage is just unrealistic.

Furthermore, as he has pointed out to you, beer, like wine, in bulk is perishable and has to be put into a bottle or a container. Our objective, we would hope, on behalf of the United States Brewers Association—and remember, sir, we represent not only the brewers of this country, we represent the people employed in our industry and the suppliers to this industry—is to take this influx of foreign beer, put it through American can lines and bottling lines, buy American bottles and American labels.

And we don't think anybody is going to argue that we should have to pay a $9 tax on spilled beer. We don't have to pay it with respect to domestic and in fact I have summarized the practical problems that the bill will cure. It will prevent the payment of an excise tax of $9 on spilled beer. It will avoid the additional transportation mess and in addition it will give us a chance to crack this market both domestically and abroad.

That is the reason that the rest of the brewers support this bill.

Chairman STARK. I appreciate your comments. I also know that it was always your job when you worked on the bottle line to make sure there were enough underfills for your friends down the line who could then drink them for lunch.

Mr. RIDDELL. St. Patrick's Day special.

Chairman STARK. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. Do you envision an increase in imported beer coming into the United States?

Mr. SUMNER. Yes, Mr. Duncan, we do. In 1980 the amount of beer versus 1979 brought in was approximately 2 percent. In 1981 that rose to 20 percent and we are calculating it to be approximately 15 percent a year increases in imported beers during the 1980's.

Mr. DUNCAN. What restrictions do we have on exporting beer in bulk to other countries, or do we have any?

Mr. SUMNER. We do not have any restrictions.

Mr. DUNCAN. Are we exporting beer in bulk?

Mr. SUMNER. We are currently negotiating with several European countries, investigating the feasibility of selling our beers in Europe and bringing it over in bulk.

Mr. DUNCAN. What effect would it have on domestic production? I mean, if you have an increase in foreign consumption of foreign beers, it would appear that you would have a decrease in domestic production. I do not quite understand why you would support this when at the present time you do not export your own beer.

Mr. **Sumner**. At the present time we are investigating the exportation in bulk. We feel that with the proper utilization of the tanks both ways that this would help us open up markets overseas, and this with our beer that is brewed domestically. We would then use an increased production here in the United States.

The year-to-year consumption figures in the United States for domestically brewed beer are increasingly roughly about 3 percent a year. We feel that we have to broaden our consumption base, which would be to export to other countries. One way of doing this is in bulk.

Mr. **Duncan**. When you say we, are you referring to all the brewing companies or only Anheuser-Busch?

Mr. **Sumner**. I am referring to at least one other brewer that I know of that I have discussed this with, and that is Pabst.

Mr. **Duncan**. But the Brewers Association does support this?

Mr. **Riddell**. Yes, we support this. Last summer, Mr. Duncan, the United States Brewers Association appeared before your Special Trade Committee. We made it plain that the principal barrier to the exportation of American beers are nontariff barriers. Our market is wide open. We have no nontariff market barriers and, as a matter of fact, the only excise tax imposed on importing beers into this country is a tax of 6 cents a gallon.

In order to open up foreign markets to beat the nontariff barriers that are confronting us on container sizes and other things, it has been thought that if we can get into the stream of importation we can begin to export.

The only way we can do that is to ship it abroad, at the present time, in bulk containers, at least that is the only thing that has been permitted so far, and bottle it under the restrictions—and many of them are totally fanciful—that are imposed by foreign countries on our products.

Mr. **Duncan**. But you do have nontariff barriers now, is that correct? I understood Mr. Sumner to say that you had none.

Mr. **Riddell**. We have none in the United States. The U.S. market is wide open to everybody.

Mr. **Duncan**. We do not, but that is the problem. I am going to support you on this legislation, but I think you are going to rue the day that you ever came here and asked for it without some guarantee that the nontariff barriers that you are having to climb abroad right now, will be removed.

Mr. **Riddell**. We have not been successful in persuading.

Mr. **Duncan**. In fact, I can see why you would argue it differently, but if you want the beer to come in without some assurance that you can sell yours abroad, I would say somebody is going the wrong direction.

Mr. **Riddell**. Mr. Duncan, you and Mr. Gibbons and other members of the committee have supported us a great deal in attempting to get the Ambassador in charge of our foreign trade relations to address these nontariff barriers and we hope that you will continue to do so.

Mr. **Duncan**. But you haven't solved that yet, though, have you?

Mr. **Riddell**. No.

Mr. DUNCAN. So I say it looks to me like you are going backward instead of forward, but I will support you.

Mr. RIDDELL. If I can make one more comment, the brewing industry within the United States in the last decade has increased its consumption roughly 40 percent in production. That, of course, takes into account demographic factors and increase in population.

At the same time, foreign imports have increased at a rate of 400 percent. The American brewer is going to have to get into this act some way and he is going to have to be able to export abroad for the benefit not only of our labor, our suppliers, but the integrity of our own product and wholesalers.

Mr. DUNCAN. But that is what we said about the automobiles a few years ago. We are seeing that it is not happening that way and I can easily envision a lot of your own members going out of business because of this.

Mr. RIDDELL. I am not authorized to suggest——

Mr. DUNCAN. Well, you understand it better than I do, and I would yield back the balance of my time.

Chairman STARK. I thank the gentleman. I want to thank the panel and Mr. Gephardt, and I assure you that we will work with Congressman Gephardt, the industry, and the Treasury to see if we cannot find an equitable solution to your dilemma.

Thank you very much.

Mr. GEPHARDT. Thank you very much.

Chairman STARK. I would like at this time to call Hon. James M. Shannon, a member of this committee from Massachusetts and note that he is accompanied by Mr. Stuart Eisenstadt, a gentleman who is not unfamiliar to us and to this committee. I want to welcome both of you. Your statement will appear in the record in its entirety and you may proceed as you so desire.

STATEMENT OF HON. JAMES M. SHANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. SHANNON. Thank you, Mr. Chairman, Mr. Duncan. Mr. Eisenstadt is with me. He has been involved in this issue representing the Intergraph Corp. of Alabama, which is one of the typical companies affected by the problem about which I am going to testify.

I would like to read a short statement and submit the longer statement for the record.

Chairman STARK. Without objection.

Mr. SHANNON. I am pleased to testify on behalf of H.R. 4444, a bill I have introduced to encourage research and development by companies receiving tax-exempt financing under industrial development bonds. The Senate companion to this bill was added to H.R. 4717, the miscellaneous tax bill, by Senator Daniel P. Moynihan of New York. I hope that this committee will give favorable consideration to my bill, and that the conference committee on H.R. 4717 will accept the Moynihan amendment.

Mr. Chairman, you and I have long shared a concern for improving the productivity of American industry by encouraging research and development by the private sector. My bill would correct an interpretation of the Internal Revenue Code which needlessly discourages research and development by companies receiving industrial development bond financing.

The Internal Revenue Code permits a company to receive financing for small issues of tax exempt industrial development bonds as long as the company does not have more than $10 million in capital expenditures within the bond-issuing jurisdiction in the 6-year period beginning 3 years prior to the issue date.

The Internal Revenue Service has held in private rulings that expenses for research are capital expenditures within the meaning of this provision. This contrasts with the normal tax treatment of R. & D. costs which, pursuant to section 174 of the Code, may be expensed rather than capitalized. In other words, research and development costs are generally permitted to be treated as expenses, but R. & D. costs in the IDB context must be treated as capital expenditures.

As a result of this IRS determination, companies which build, renovate or expand their facilities through the use of IDB's must avoid or curtail their research expenditures for a 6-year period in order to stay within the $10 million limit.

Even more seriously, the small, high technology firms that are on the cutting edge of this Nation's innovation and productivity are effectively denied the advantages of tax-exempt financing. If a firm spends a large share of its budget on research and development, it cannot afford to finance its capital facilities—land, plant and equipment—through an industrial development bond.

In addition to its adverse impact on research, the current rule needlessly compounds the bureaucratic burden upon businesses. The business which uses an industrial development bond must analyze all of its expenditures in the preceding 3 years, separating out research, and must segregate research expenditures for the subsequent 3 years as well.

My bill offers a simple solution to these problems. It provides that research and experimental costs which are treated as expenses for the purposes of section 174 shall also be expenses for the purposes of the small-issue exemption under section 103(b)(6). Thus, the bill will permit firms which use IDB financing to carry out normal research and experimentation activities and permit those high technology firms which depend heavily on research and innovation to benefit from tax-exempt financing.

The bill's revenue impact will be negligible. The research and development expenditures to which it would apply cannot themselves be funded out of the proceeds of an industrial development bond issue. IDB's basically can only fund capital costs for plants and equipment. Thus, the number and size of IDB issues should not increase significantly.

I understand that the administration does not oppose enactment of this bill. Testifying before the Senate last September, Assistant Secretary Chapoton noted the need for the bill and its merit. I understand there were some concerns about the overall IDB issue and there were some concerns expressed by Mr. Chapoton before the Senate and perhaps today about what he called a piecemeal approach to the IDB issues in view of the administration's effort to deal with IDB's comprehensively.

But it is now 6 months since that testimony was delivered before the Senate and the administration has only recently explained the proposal which it will put forth on IDB's, not mentioning the R. & D. issue. Thus, it would seem that the reservations previously expressed by Mr. Chapoton no longer stand.

Further, when the Senate Finance Committee added these provisions to H.R. 4717 last December, the administration expressed no opposition to them at that time.

I would also note that it is neither necessary nor desirable to await action on the administration package and other comprehensive proposals on IDB's before acting on this bill. The bill I have introduced stands on its own feet with broad recognition of its importance. It can be enacted quickly and produce immediate benefits.

Morever, the concerns expressed over the uses of industrial development bonds do not mitigate against H.R. 4444. Indeed, they point up the need for this legislation. Objections have been raised to the use of IDB's by big national corporations to establish franchises in a number of areas or to finance shopping centers, fast food outlets, and retail stores. The current treatment of research and development costs for IDB's purposes tends to aggravate the situation, discouraging manufacturers and locally based businesses.

A manufacturer, particularly one in the highly competitive new technology fields, must constantly improve and develop his product, spending substantially for research and thereby running into the capital expenditure limitation. Further, while a national corporation has considerable latitude to allocate or disburse its research activities in such a fashion as to avoid hitting the expenditure limitation within any one jurisdiction, a concern located in a single area has no such leeway.

Thus, regardless of what the Congress ultimately decides to do about industrial development bond financing, this legislation will help to encourage the most productive use of IDB's and be consistent with any reasonable comprehensive reform measure.

In conclusion, I would suggest that the bill be made applicable to R. & D. expenditures made after the date of enactment and to R. & D. expenditures under bonds issued after the date of enactment. The latter clause should be added because if it is not, businesses operating under new IDB's will still be forced to segregate and capitalize their earlier R. & D. costs.

Mr. Chairman, I appreciate your courtesy in allowing me to testify this morning and I urge you and the members of the committee to give prompt favorable consideration to H.R. 4444.

[The prepared statement follows:]

STATEMENT OF HON. JAMES M. SHANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. Chairman, Members of the Committee, I am pleased to testify in favor of H.R. 4444, a bill I have introduced to encourage research and development by companies receiving tax-exempt financing under industrial development bonds. The Senate companion to this bill was added to H.R. 4717, the miscellaneous tax bill, by Senator Daniel P. Moynihan of New York. I hope that this Committee will give favorable consideration to my bill, and that the Conference Committee on H.R. 4717 will accept the Moynihan amendment.

Mr. Chairman, no factor is more important to improving the productivity of American industry and increasing our ability to compete successfully with foreign companies than adequate levels of research and development by the private sector. Yet the Internal Revenue Code needlessly discourages R&D by companies receiving industrial development bond financing and thereby denies the most innovative companies access to the favorable financing terms made available by IDBs. H.R. 4444 would correct this problem.

Section 103(b)(6) of the Internal Revenue Code permits a company to receive financing through "small issues" of tax-exempt industrial development bonds, as long as the company does not have more than $10 million in capital expenditures within the bond-issuing jurisdiction in the six year period beginning three years prior to the issue date. I would stress that this $10 million cap applies to all of a company's capital expenditures in that 6 year period, not only those actually financed by the IDB.

The Internal Revenue Service has held in private rulings that expenses for research are "capital expenditures" within the meaning of this provision. This contrasts with the normal tax treatment of R&D costs which, pursuant to Section 174 of the Code, may be expensed rather than capitalized. In other words, because of Section 174, research and development costs are generally permitted to be treated as expenses. Because of the IRS rulings, however, R&D costs in the IDB context must be treated as capital expenditures, even if they are treated as expenses for all other purposes.

This IRS determination has had unfortunate consequences for research by American industry. Those companies which build, renovate or expand their facilities through the use of

IDBs must avoid or curtail their research expenditures for a six year period in order to stay within the $10 million limit. Even more seriously, the small, high technology firms that are on the cutting edge of this nation's innovation and productivity are effectively denied the advantages of tax-exempt financing. For if a firm spends a large share of its budget on research and development, it cannot afford to finance its capital facilities -- land, plant, and equipment -- through an industrial development bond.

In summary, companies which do little or no R&D actually are treated more favorably under the IDB rules.

Because of this treatment, small, innovative companies throughout the nation which depend upon R&D to keep their products current and competitive cannot use IDBs to finance their plant and equipment. It is for this reason that the American Electronics Association, on behalf of the Nation's electronics industry, supports H. R. 4444.

In addition to its adverse impact on research, the current rule needlessly compounds the bureaucratic burden upon businesses. Section 174 was intended to end the need for companies to separate their research and development expenses from normal operating expenses, and avoid repeated audits and challenges on this point. The treatment of IDBs raises these problems all over again. A business which uses an industrial development bond must analyze all of its expenditures in the preceding 3 years, separating out research, and must segregate research expenditures for the subsequent 3 years as well. And because this determination can always be challenged, the bond issue's tax exemption may be uncertain.

My bill offers a simple solution to these problems. It provides that research and experimental costs which are treated as expenses for the purposes of Section 174 shall also be expenses for the purposes of the "small-issue exemption" under Section 103(b)(6). By doing so, the bill provides uniform treatment for research and development expenses in the Code, and avoids the uncertainty and unnecessary accounting problems created by the present IRS position. The bill will permit firms which use IDB financing to carry out normal research and experimentation activities, and it will permit those high technology firms which depend heavily on research and innovation to benefit from tax-exempt financing.

The bill's revenue impact will be negligible. The research and development expenditures to which it would apply cannot themselves be funded out of the proceeds of an industrial development bond issue. IDBs basically can only fund capital costs for plant and equipment. Thus the number and size of IDB issues should not increase significantly. However, this valuable low-cost financing tool will cease to be denied to those companies which help to advance American technology and industry solely because of their high research costs.

I understand that the Administration does not oppose enactment of this bill. Testifying before the Senate Finance Subcommittee on Taxation and Debt Management on September 25, 1981, Assistant Secretary of the Treasury for Tax Policy John Chapoton noted the need for the bill and its merit. At that time, however, he opposed what he called "a piecemeal approach" to IDB issues in view of the Administration's promised effort to deal with IDBs comprehensively. As we know, it is now six months later and the Administration has only recently explained the proposal which it will put forth on IDBs. This explanation does not mention the R&D issue, and while I am not aware that Treasury has actually transmitted a bill on the subject, I have no reason to believe that the Administration legislation, whenever it is proposed, will deal with the matter. Thus, it would seem that the reservations expressed by Mr. Chapoton last September no longer stand.

Further, when the Senate Finance Committee added these provisions to H.R. 4717 last December, the Administration expressed no opposition to them.

I would also note that it is neither necessary nor desirable to await action on the Administration package and other comprehensive proposals on IDBs before acting on this bill. As an independent measure, added to H.R. 4717, the bill I have introduced stands on its own feet, with broad recognition of its importance. While there will likely be extensive consideration of the Administration's proposals, this measure can be enacted quickly and produce immediate benefits.

Moreover, while certain uses of industrial development bonds have been the subject of concerns expressed by the Administration, the Congressional Budget Office and others, these concerns do not militate against H.R. 4444. Indeed, they point up the need for this legislation. Objections have been raised to the use of IDBs by big national corporations to establish franchises in a number of areas, or to finance shopping centers, fast food outlets and retail stores. These uses, it is argued, are contrary to Congress's intent that IDBs be used to promote growth by local businesses, and to stimulate manufacturing and production.

Without conceding the validity of these objections, I would point out that the current treatment of research and development costs for IDB purposes tends to aggravate this situation, discouraging manufacturers and locally-based businesses. A retailer need not worry about product development or experimentation; his main capital expenditure is for the building, with product and labor costs coming out of expenses. A manufacturer, on the other hand, particularly one in the highly competitive, new technology fields, must constantly improve and develop his product, spending substantially for research, thereby running into the capital expenditure limitation. Similarly, a national corporation has considerable latitude to allocate or disperse its research activities in such a fashion as to avoid hitting the expenditure limitation within any one jurisdiction. A concern located in a single area has no such leeway. Thus, regardless of what the Congress ultimately decides to do about industrial development bond financing, this legislation will help to encourage the most productive use of IDBs and be consistent with any reasonable comprehensive reform measure.

In conclusion, I would note that the Senate amendment differs from the bill I have introduced in two respects. First, the actual language effectuating the change is somewhat different. On this point, I believe the approach in H.R. 4444 is preferable, but I would yield to the judgment of this Committee and its staff. Second, the Senate amendment applies to all R&D expenditures made after the date of enactment of the provision, regardless of when the underlying IDB was issued. I believe this to be the sound approach, since it would remove the disincentive to research immediately.

In this regard, I would suggest that the bill be made applicable to R&D expendiures made after the date of enactment and to R&D expenditures under bonds issued after the date of enactment. The latter clause should be added because if it is not, businesses operating under new IDBs will still be forced to segregate and capitalize their earlier R&D costs.

Mr. Chairman, I appreciate your courtesy in allowing me to testify this morning, and I urge you to give prompt favorable consideration to H.R. 4444. Thank you.

Chairman **Stark**. Thank you very much, Congressman Shannon. I think you make an excellent point. If I understand the problem correctly, in a community that can otherwise qualify to issue small industrial development bonds you could build a 60,000-square-foot K Mart or a building for $3 million and issue the bonds. But if you had a research operation that was developing computers or other products which might help us compete, or a brandnew product, and they had over the past 3 years, I guess, exceeded $10 million in expenses in research and development and wanted to build a $3 million 60,000-square-foot building to assemble these products, they would be precluded because of the previous expenditures in developing the product.

Mr. **Shannon**. That is basically right, Mr. Chairman. The research and development costs are considered capital expenditures for purposes of this limitation, although elsewhere in the Code, under section 174, those same costs would be allowed to be expensed. What that means is that a K-mart does not have to use or count the services or wages paid to a janitor for purposes of considering its limitation, but a small computer firm in Massachusetts or California or in the South would have to count the services of wages paid to an engineer as part of its capital expenditures for purposes of that limitation.

That seems to me to be a very unwise course for us if we are trying to encourage the small growth industries and trying to increase productivity in our economy.

Chairman **Stark**. Thank you very much. We appreciate your taking the time to testify and we will work with you to see if we can't solve whatever backsliding the Treasury may have been involved in since last we discussed this issue with them.

Mr. **Shannon**. Thank you very much, Mr. Chairman.

Chairman **Stark**. Is Mr. Morris in the committee room? At this time we will call William Morris, counsel for Fred T. Franzia, John G. Franzia, Jr., and Joseph S. Franzia. Welcome to the committee, Mr. Morris.

Your prepared statement will appear in the record and you may proceed.

STATEMENT OF WILLIAM MORRIS, COUNSEL FOR FRED T. FRANZIA, JOHN G. FRANZIA, JR., AND JOSEPH S. FRANZIA

Mr. **Morris**. Thank you very much, Mr. Chairman. I would like to thank you and the other members of the subcommittee for providing us with this opportunity to testify before the subcommittee on H.R. 4577. I have attached a short summary on top of my prepared statement.

My name is William Morris. I am appearing before the subcommittee as a representative of Fred T. Franzia, John G. Franzia, Jr., and Joseph S. Franzia.

H.R. 4577 would revise the effective date of section 252 of the Economic Recovery Tax Act by substituting the same effective date originally approved by the Ways and Means Committee on July 22, 1981 and reported as part of H.R. 4242.

This provision would simply say that Federal restrictions which effectively deny taxpayers the right to dispose of stock which they receive until those restrictions lapse would not be taxable until those restrictions actually lapse. The Treasury Department's testimony before the committee has indicated that it agrees with this general rule and that the Treasury supported the enactment of the rule in the Economic Recovery Tax Act of 1981.

The point we wish to make to the subcommittee is that the law should apply whether the transactions occurred before or after December 31, 1981, and we would suggest that be done within the framework of the orderly administration of the tax laws. What we mean by that is that the provision should apply only to years which remain open under the statute of limitations or are the subject of pending cases.

Secretary Chapoton in his testimony to the subcommittee indicated that H.R. 4577 provides the taxpayer with the right to elect the new rules under section 83(c)(3) for all years subsequent to 1969 whether those years are closed or not under the statute of limitations.

I believe we have a misunderstanding on that point. The bill, as drafted, does not provide that all years after 1969 would be per se accorded to the relief provided under section 83(c)(3). It provides, and we simply intended it to provide, that only those years which are open under the statute of limitations or are the subject of pending cases would be covered. Had we intended to override the statute of limitations, we would have specifically so provided with language that specifically indicated that was our intention.

Also, Secretary Chapoton said in his oral presentation and in his written statement at page 21 that the extension of these new rules are provided on an optional basis. While we would not object to simply applying the new rules to past years that are covered, we believe such a rule would be highly disruptive to the orderly administration of the tax laws and believe that the optional approach is far more desirable from an administrative standpoint.

We would like to point out that there is ample precedent for providing this kind of change. In 1971 the Congress provided similar relief for innocent spouses. In 1978 it provided similar relief for perfecting elections made by subchapter S corporations and also in 1978 provided similar relief for cash meal allowances of State troopers. The details of each of those provisions are set forth on pages 3 and 4 of my prepared statement.

Finally, Mr. Chairman, I would note for the committee that there are a large number of employees of various companies that would be affected by this legislation which have been brought to my attention. Thank you very much.

[The prepared statement follows:]

STATEMENT OF WILLIAM MORRIS, WASHINGTON, D.C.

SUMMARY

1. H.R. 4577 would revise the effective date of Section 252 of the Economic Recovery Tax Act of 1981 by substituting the identical effective date originally approved for this provision by the Ways and Means Committee in H.R. 4242, as reported by the Committee.

2. Federal restrictions which effectively deny certain employees (referred to as "insiders") of the ability to dispose of stock for a fixed period of time after receipt of the stock shold be taken into account and no tax on any gain in value should be imposed until such time as the Federal restrictions (Section 16(b) of the Securities Exchange Act or "Pooling-of-Interests Accounting rules) lapse and the employee is free to sell his stock, whether the transaction takes place before or after December 31, 1981.

3. There is ample precedent for the Congress to extend the revised rules added as an amendment to Section 83 of the Code by P.L. 97-34 to all taxpayers whose taxable years remain open under the statute of limitations or are the subject of pending cases. For example, in 1971 such an approach was followed in providing relief for "innocent spouses". In 1978, relief was provided for the filing of subchapter S perfecting elections for all years and also in 1978, the Congress approved a provision for the relief of state troopers by making the holding of the Supreme Court in the Kowalski case prospective only, thereby not requiring those individuals to treat certain cash meal allowances paid to them during the years 1970-1976 as taxable income.

STATEMENT

My name is William Morris. I am a member of the law firm of Leighton Conklin Lemov Jacobs and Buckley located in Washington, D.C. I am appearing before this subcommittee today on behalf of three individuals, Messers Fred T. Franzia, John G. Franzia, Jr. and Joseph S. Franzia, with offices in Ceres, California. We are here today to ask the Subcommittee to give favorable consideration to H.R. 4577.

This bill would amend P.L. 97-34, The Economic Recovery Tax Act of 1981, by changing the effective date of Section 252 of that Act to provide that it would apply to transactions that occurred in taxable years still open under the statute of limitations or the subject of pending cases. The revised effective date we seek is the identical effective date the Ways and Means Committee approved on July 22, 1981, when it agreed to amend Section 83 of the Internal Revenue Code (IRC) which contains rules for the taxation of property transferred by an employer to an employee.

Generally, if property (including stock) received by an employee is not transferable or is subject to a substantial risk of forfeiture (such as the obligation to perform future sevices), taxation is postponed until the stock or other property is transferable or is no longer subject to a substantial risk of forfeiture. In construing this general rule the IRS argues that Section 16(b) of the Securities Exchange Act of 1934, under which an "insider's" profit may be recovered by a corporation if the stock is sold within six months of receipt, does not make the stock nontransferable, and therefore does not affect the taxation of the stock. Thus, the value of the stock (less any amount paid) is treated as compensation when received, by the IRS.

During Ways and Means Committee consideration of the Economic Recovery Tax Act of 1981, we brought this matter and similar situations to the attention of the members of the full committee. On July 22, 1981, the Committee, after two roll call votes, of 25-5 and 21-9, agreed to revise the tax treatment for stock received by an employee subject to the restrictions of Section 16(b) of the Securities Exchange Act of 1934. The Committee, at page 263 of its Report to accompany H.R. 4242 (H. Rept. 97-201, July 24, 1981) stated:

> "The committee believes that the imposition of Federal restrictions, which limit the ability of an "insider" to dispose of stock for a short period of time after receipt, should be taken into account in determining the manner in which the value of the stock should be included in income. Because of mandated restriction on transferability, the committee believes it may be inequitable to tax the employee before the restriction lapses.

The Report then explained the provisions approved, which consisted of two parts, the first providing that stock received subject to Section 16(b) of the Securities Exchange Act of 1934 would be treated as being subject to a substantial risk of forfeiture and the second providing that stock subject to the Securities and Exchange Commission's "Pooling-of-Interests Accounting" rules would be similarly treated.

Finally, because of the unduly harsh result under the IRS' interpretation of Section 83, imposing Federal income tax on income that has not been realized and may never be realized, the Committee agreed to make the provision applicable to all taxpayers who could be affected by the change and who were eligible to file amended returns or claim relief in cases presently pending before the Courts, if the taxpayer elected the relief provided.

Subsequently, the House agreed to substitute the Administration - backed Conable-Hance substitute for H.R. 4242 as reported by the Ways and Means Committee. In approving the substitute, the relief granted under this provision was limited to only transactions occurring after 1981. The provision, as approved as part of the Conable-Hance substitute was then agreed to by House - Senate Conferees and was signed into law as part of P.L. 97-34 on August 13, 1981. *

In approving the addition of subsection (c)(3) to Section 83, the Congress recognized the fundamental unfairness of determining taxable income before it is possible to realize that income. In correcting similar inequitable situations in the tax laws, the Congress has attempted to extend the benefit of remedial legislation to all those who could qualify within the framework of the normal rules for the collection of taxes and filing of claims for refund and has generally not limited relief to merely those who would be "wronged" after some abitrary future date.

For example, in 1971 (P.L. 91-679, January 12, 1971) the Congress approved legislation adding subsection (e) to Section 6013 to correct the unfairness of prior law under which individuals filing joint income tax returns could be held liable for additional taxes and the 50 percent fraud penalty as a result of the fraudulent omission of income on a joint return by their spouse, even though they had no knowledge of their spouse's activities and omission of income and derived no benefit from the use of such funds.

The amendments approved to correct this situation were made applicable to all taxable years covered by the Internal Revenue Code of 1954. Only taxpayers whose taxable years could not be opened under the statute of limitations or whose cases were closed and barred from reopening under the doctrine of res judicata were not covered by the statutory change.

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* It should be noted that Congressional approval of this provision represents a partial acceptance of an original Treasury Department proposal put forward in 1969 when Section 83 was first made a part of the Internal Revenue Code. The Treasury department urged at that time, but the Ways and Means Committee rejected without explanation, a proposal to permit Federal Securities law restrictions to be taken into account in determining the fair market value of restricted stock. See Technical Explanation of Treasury Tax Reform Proposals, Hearings Before House Committee on Ways and Means on the Subject of Tax Reform, 91st Cong., 1st Sess., 5206-07.

More recently, in 1978, P.L. 95-628 (May 10, 1978) was approved, revising various timing requirements under the tax laws. This measure included a provision applicable to subchapter S corporations and the filing of an effective election to be treated as a subchapter S corporation. The rules for filing such elections were liberalized and the time period extended. In addition, a special rule was incorporated in the provision to permit subchapter S corporations to perfect their elections for all prior taxable years, without limitation.

Also in 1978, after the Supreme Court in Commissioner v. Kowalski, 434 U.S. 77 (1977) finally resolved the conflict among the various appellate courts over the issue of whether cash meal allowances paid to state troopers were not subject to tax under Section 119, the Congress provided that statutory subsistance allowances should only be subject to Federal income tax prospectively and that such allowances should be excluded from tax during the years 1970 through 1976. See P.L. 95-427 (October 7, 1978) and H. Rept. 95-1232. An important factor brought to the attention of the Congress regarding the impact of the Kowalski decision was that in a number of cases, if the Court's decision were not made prospective, the total additional tax due together with interest for the period 1970-1976 could exceed the annual salaries of some state troopers.

In the instant case, the situation is even more egregious. Taxpayers are being required by the IRS to include in income gains which were never realized and in fact, could never be realized.

In P.L. 97-34, The Economic Recovery Tax Act of 1981, the Congress recognized the inequity involved in taxing employees on the receipt of stock which they are effectively prohibited from selling at a profit for a six month period. In urging the adoption of H.R. 4577, we are simply asking that the inequity previously removed for past transactions as well as future transactions by the full Ways and Means Committee on July 22, 1981, be once again approved by this Subcommittee and the full Ways and Means Committee so those individuals who may still do so without bar under the normal statute of limitations or within the context of a pending case may be granted the same tax treatment as those persons to whom Section 83(c)(3) applies after December 31, 1981.

Attached to my prepared statement is a copy of the pertinent pages from the Committee's Report on H.R. 4242 (House Report 97-201, July 24, 1981) explaining the amendments approved to Section 83 of the Code. Also attached are two articles, one from the February 15, 1981 edition of the New York Times and the other from the April 15, 1981 issue of Financial World commenting on the unfairness of the IRS position under Section 83, seeking to tax employees subject to the "Section 16(b)" restriction immediately on the full fair market value of stock received when, if there is any profit, the Securities and Exchange Commission can take away that profit the moment it is realized.

Thank you, Mr. Chairman, for providing us with this opportunity to present our case to the Subcommittee. We hope you share our concern about the fundamental unfairness of the present situation and recognize the extensive precedent that exists for extending the relief approved in P.L. 97-34 to all taxpayers not barred by the statute of limitations or who have cases pending before the courts and who elect to avail themselves of such relief.

97th Congress, 1st Session } HOUSE OF REPRESENTATIVES { Report No. 97-201

TAX INCENTIVE ACT OF 1981

REPORT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ON

H.R. 4242

together with

ADDITIONAL, MINORITY, AND ADDITIONAL DISSENTING VIEWS

July 24, 1981.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

2. Property transferred to employees subject to certain restrictions (sec. 810 of the bill and sec. 83 of the Code)

Present Law

Under present law, the taxation of property transferred by an employer to an employee as compensation is governed by section 83.

Generally, if property (including stock) received is not transferable or is subject to a substantial risk of forfeiture (such as the obligation to perform future services), taxation is postponed until the stock or the property is transferable or is no longer subject to a substantial risk of forfeiture. The Tax Court has ruled[1] that section 16(b) of the Securities Exchange Act of 1934, under which an "insider's" profit may be recovered by a corporation if the stock is sold within six months of receipt, does not make the stock nontransferable, and therefore does not affect the taxation of the stock. Thus, the value of the stock (less any amount paid) is treated as compensation when received.

An employer generally is allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year (sec. 83(h)).

Reasons for Change

The committee believes that the imposition of Federal restrictions, which limit the ability of an "insider" to dispose of stock for a short period of time after receipt, should be taken into account in determining the manner in which the value of the stock should be included in income. Because of mandated restriction on transferability, the committee believes it may be inequitable to tax the employee before the restriction lapses.

Explanation of Provision

Under the provision, a taxpayer who receives stock subject to the application of section 16(b) of the Securities and Exchange Act of 1934 will be treated as being subject to a substantial risk of forfeiture for the 6-month period during which that section applies. Thus, the employee will include in income, and the employer may deduct, at the time the restriction lapses, the difference between the value of the stock at that time and the amount paid for the stock (if any).

A similar rule is applicable if the stock is subject to restriction by reason of the need to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; CFR 211.135).

Effective Date

The provision will apply to taxable years ending after June 30, 1969. However, for taxable years beginning before January 1, 1982, the provision will apply only if the person receiving the property elects, in accordance with Treasury regulations, to have the provision apply.

Revenue Effect

This provision is estimated to affect revenues by less than $15 million.

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[1] *Horwith v. Comm'r.*, 71 T.C. 932 (1979).

NEW YORK TIMES
February 15, 1981

Taxes and Options

By GRAEF S. CRYSTAL

FACTS: XYZ Corporation rewarded John Smith, one of its officers, for a fine performance by granting him an option on the company's stock. Mr. Smith exercised the options in June, paying $500,000, in borrowed money, for stock that had a fair market value of $900,000 at the time. Being a corporate officer, he was constrained from selling the stock for at least six months — or else, under Securities and Exchange Commission rules, he would have to return any profits to the company.

Shortly after exercise, the market took one of its frequent nosedives, and XYZ stock plummeted. When the stock hit the same $500,000 value as Mr. Smith paid for it, he prudently sold it. He hadn't waited six months, but he didn't have to because he had no profit.

The "reward" had backfired a bit, but Mr. Smith emerged relatively unscathed. Until the tax man came. Dialogue between Mr. Smith and his accountant the following April:

Accountant: I have the details on your salary and bonus for last year, but did you also exercise an option?

Mr. Smith: I sure did, but I never made a cent on it. In fact, I took a loss, because I incurred interest costs on a $500,000 loan between the date I exercised the option and the date I finally sold it. So let's forget about that.

Larry Engel

Accountant: Not so fast! According to the Internal Revenue Service code, we have to include in your gross income the difference between what you paid for the stock and its value on the date you bought it. How much was that?

Mr. Smith: It was $400,000. So O.K., you have to include it in my gross income, but you can turn right around and take a short-term capital loss for $400,000. After all, if I have to increase my cost basis from $500,000 to $900,000, aren't I entitled to a loss deduction if I then sell the stock for $500,000?

Accountant: Right. You have a $400,000 capital loss. But let me ask you this, do you have any capital gains against which we can offset the loss?

Mr. Smith: You got to be kidding! In this market?

Accountant: Well, in that case, we can go ahead and deduct the loss . . .

Mr. Smith: That's what I just said, so let's get on with it.

Accountant: You didn't let me finish. We can go ahead and deduct the loss, but at the rate of $3,000 per year. So let's see, you owe $200,000 tax on the $400,000 option gain, but the $3,000 loss will save you $1,500 in tax. So you owe only $198,500 in additional taxes. But cheer up, you can deduct another $3,000 each year and get another $1,500 back from the Government. Why, in 132 more years, you'll have your money back!

Under I.R.S. principles, virtually all individual taxpayers recognize income in the year it is actually or constructively received. And according to the I.R.S., the gain on exercise of most of the stock options offered today is income in the year of exercise. Obviously, the theory is that the taxpayer could, if he or she wished, sell the stock after exercise and actually realize the paper gain.

But the I.R.S. theorists don't seem to pay any attention to the S.E.C. theorists. The latter take the position that a corporate officer or other insider must return any profit to the company if stock is sold within six months.

Recognizing the tremendous conflict between the positions of the two agencies, the S.E.C. permits a company to pay the individual — in cash — the equivalent of the profit he or she might have realized on the option, which is then canceled, provided certain not terribly onerous conditions are met. The transaction goes under the handle of a Stock Appreciation Right.

However, payment of cash causes the company to lose cash flow and, more important, the company ends up having to charge the entire payment to its earnings. (There would be no charge to earnings for exercising the option itself, provided the option price was not discounted at the time of grant.) What is more, the executive who might like to hold on to the shares is denied this privilege, thereby vitiating one of the underlying purposes of an option plan.

Wouldn't it make sense for the I.R.S. to apply its own concepts of constructive receipt? How can option profits be constructively received by a corporate officer if the S.E.C. will take them away the minute the officer tries to lay his or her hands on them? A more reasonable position on the part of the I.R.S. would be to delay the date of income receipt until the executive was clear of the six-month holding period imposed by the S.E.C. Then the executive could truly realize the profits, if there are any, and then a tax would clearly be due.

It's a pity, but if your name's on the door and you've got a Bigelow on the floor, the I.R.S. will bore for more. ◻

Graef S. Crystal is vice president of Towers, Perrin, Forster & Crosby.

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PERSPECTIVE

A call to options

There seems to be a presumption in government that anything that works, needs to be reformed. Especially if anyone has made any money.

Given this criterion, just think how attractive executive stock options must have seemed as a reform target when Congress was putting together the tax reform acts in 1969 and 1976.

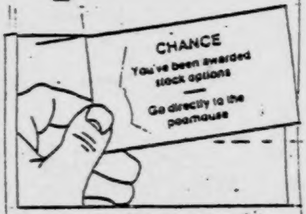
The convoluted result would even make Rube Goldberg sit up in admiration of a system so well designed to do nothing—nothing positive, that is.

Since executive options are supposed to be tools available to public companies to attract, hold and motivate valuable employees, let's see how well the reformed rules work.

Congratulations! You have just been awarded options on 10,000 shares of your company's stock at $10 per share. This is truly your lucky day because the stock is currently trading at $15. Great! You can put up or borrow $100,000 and realize a $50,000 profit today. Well, not exactly. Last year you were made a vice president of the company. Now you learn that as a company officer you can't sell the stock for six months. O.K., you say. I'll hold. I'm here for the long pull anyway and it's only costing me interest on the $100,000.

Sorry, wrong again. Your tax attorney now tells you that even though you made no sale and haven't realized a penny of profit, you will owe an ordinary income tax on the $50,000 difference between your exercise price and the current market price. Let's say you are in the 50% bracket. So you come up with $25,000 for taxes. Now you have $125,000 in this thing and still no profit. You're beginning to wonder if the board of directors was trying to reward you or ruin you.

Some time passes and the stock declines to $7.50 per share. You can't afford to hold it any longer and finally sell your 10,000 shares for $75,000. You have a $25,000 loss on the stock, and you've paid $25,000 in taxes in addition. Your tax relief? Since you didn't happen to have any capital gains that year you deduct only $3,000.


CHANCE
You've been awarded stock options
Go directly to the poorhouse

That certainly should spur you on to bigger and better things. Who knows, maybe if you really perform well they'll double the option grant next year...and send you straight to the poorhouse.

The fact is that this seemingly improbable idiocy *is* actually the way the system works—or doesn't work. These rules have just about eliminated the value of stock options as an incentive to employees.

Who cares? Obviously, up until now Washington hasn't. But it's up to us to make them care. The performance of American business, after all, is nothing more than the collective effort of men and women working for rewards. If we can't provide the proper incentives, the American economy and the shareholders of American businesses are the losers.

Currently, there is some movement to change the rules and restore the system. Bills have been introduced by Senators Bob Packwood, Gaylord Nelson and Alan Cranston. In the House, bills sponsored by Jim Jones and Bill Frenzel have also been introduced.

The nuances of each of these bills I'm sure will be argued at length, but what's important is that *some* bill be passed that restores the value of this important incentive.

In the future, when congratulations are offered, the recipient should once again be able to say "Great!" instead of "Ugh."

Robert L Weingarten
Publisher

Chairman STARK. Would you repeat the retroactivity precedents that you have just outlined?

Mr. MORRIS. The three particular provisions I referred to involve relief for innocent spouses, the relief provided to perfecting elections for subchapter S corporations, and the relief provided to State troopers in the case of cash meal allowances.

Chairman STARK. I just want to commend the witness on his perspicuity and his tact in leaving out retroactivity for Members of Congress, which seemed to slip through last year. I think that shows excellent judgment.

Mr. Duncan.

Mr. DUNCAN. I have no questions.

Chairman STARK. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman.

Mr. Morris, your citing of the list where Congress in the past has made a retroactive change in the tax laws, I take it means that you do concede that what you are asking for is a retroactive amendment?

Mr. MORRIS. Well, what we are asking for is a change that would provide relief not only prospectively but to people whose taxable years are still open.

I would like to point out that the provision was approved in August of 1981. There are many individuals who received stock subject to the restrictions of section 16(b) of the Securities Exchange Act between August 1981 and December 31, 1981, who are adversely affected and who are not entitled to the relief under the provision approved. Since the provision is really a provision to remove an exceedingly onerous burden on individuals, where they have been taxed on income that they never realized and in fact could not have realized, it seems only appropriate to make the change in the law applicable to anybody that would be covered by the provision within the context of the orderly administration of the tax laws.

Mr. VANDER JAGT. Are you saying that you would intend this to be applied only to tax determinations on transactions that still remain open?

Mr. MORRIS. That is correct.

Mr. VANDER JAGT. But you would retroactively apply the determination?

Mr. MORRIS. The change would apply in the case of any individual whose taxable year is still open under the statute of limitations and under ordinary circumstances that would mean for the years 1978, 1979, and 1980, plus any taxpayer who has a pending case before the courts, which is open as a result of that litigation.

We would not, as Secretary Chapoton suggested in his testimony, go back all the way to 1969.

Mr. VANDER JAGT. But you would retroactively apply the law to making a determination as to the basis.

Mr. MORRIS. Well, you raise an interesting question. In 1969 when section 83 was originally proposed the Treasury Department suggested to this committee that Federal securities law restrictions be taken into account in valuing stock received and subject to tax under section 83. This committee rejected that proposal without any explanation and adopted section 83 as it stood until 1981 when it was amended.

In effect, what we are really asking for is, to the extent possible, that the objective of Treasury's original proposals back in 1969 be extended to everybody who can benefit from that proposal.

Mr. VANDER JAGT. Thank you. Thank you, Mr. Chairman.

Chairman STARK. Thank you, Mr. Morris.

Mr. MORRIS. Thank you very much, Mr. Chairman.

Chairman STARK. At this time I would like to call the gentlemen representing the U.S. Olympic Committee, Mr. Hough, the National Club Association, Mr. Lehrfeld back with us again, and Mr. Stephen B. Cohen, Esq., of Chicago, Ill.

The Chair at this time would like to recognize the author of the bill, Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman, for recognizing me. I merely wanted to take this opportunity to welcome our distinguished panel, who will be giving testimony on a very, very necessary bill. I think every member of this committee wants to correct a situation that has evolved.

I must apologize to the members of the panel that I will not be here to hear their testimony. There is only one subject dearer to my heart than the subject of this bill, and that is redistricting in the State of Michigan because it will determine whether I am back next year to enjoy and observe the benefits that this bill will have in promoting athletic competition.

Welcome and I know that I leave your testimony and appearance in the very capable hands of the ranking minority member and the distinguished Chairman. Thank you, Mr. Chairman.

Chairman STARK. Gentlemen, welcome to the committee. We will make your prepared testimony part of the record.

Mr. Hough, would you like to lead off. Proceed in any fashion you prefer.

STATEMENT OF LAWRENCE A. HOUGH, TREASURER, U.S. OLYMPIC COMMITTEE

Mr. HOUGH. Thank you, Mr. Chairman. I am Lawrence Hough, treasurer of the U.S. Olympic Committee, a position which I hold as a volunteer. I competed in the international rowing competition, including the Olympics of 1968 and 1972.

I would first like to thank you for the opportunity to present the views of the U.S. Olympic Committee and the various national governing bodies which represent Olympic and Pan American games sports in the United States. We are here, as you know, to support H.R. 4990, which as you also know pertains to 501(c)(3) status.

Before introducing the next of our speakers, I would like to comment on the issue from my perspective. In my 11 years of postcollegiate international rowing competition I was heavily dependent on financial support I raised and received through tax-exempt organizations. These funds supported the purchase of expensive rowing equipment, my overseas travel to attend competition against the best athletes, including those of the Eastern bloc, and also substantial expenses related to training in this country.

As I mentioned, a large portion of the support was made possible because of the existence of the tax-exempt foundations and organizations. This financial support represented the difference between going and staying home. Moreover, it enabled me to stay with my sport long enough to place me at the top of international competitive sport in my event.

Although time has passed quickly since 1976, I have maintained current knowledge on how our best athletes today supporting training and competition. There have been some important changes since I retired.

First, athletes of the foreign countries, especially those in the Eastern bloc, are much better prepared and better equipped than was the case just a few years ago. Second, the cost of training up to these higher international levels, the expense of equipment, and the expense of going overseas are today much higher than at any time in previous history.

Finally, the strength in the U.S. Olympic Committee and its closer working relationship with the national governing body which resulted from the 1976 Amateur Sports Act have filled an important gap in compiling the resources needed to compete better overseas. Without doubt, the gap in financial strength that we are yet to close depends on the 501(c)(3) status which we have enjoyed up until recently.

As Congressman Vander Jagt noted, this is a technical bill which really corrects a deficiency that we tried to correct some 4 years ago. Its timing is immediate in that it is particularly significant as we look forward just 2 years from now to participating in the Olympic games in Los Angeles, which I would like to note is the first time in a great many years that this country has had the honor of hosting the summer Olympic games.

Programs we need to have in place this summer require relief from the present problem. Earlier testimony by the Treasury alluded to a technical change which they favor that would limit the amount of gift support that could be made. This form of amendment would be both harmful and, I believe, unprecedented. I should point out that no such limitation exists on donations to the Boy Scouts, universities, and numerous other 501(c)(3) organizations.

I strongly recommend that we not consider this form of limitation suggested by Treasury and that before we go forward with H.R. 4990, we remove this particular restriction.

Thank you. At this time I would like to introduce Ross Wales, former Olympic swimmer and president of U.S. Swimming Inc., and general counsel for U.S. Diving.

Chairman **Stark**. Welcome to the committee, Mr. Wales. We have a prepared statement, I believe, which will appear in the record and you may summarize and add any comments you wish.

STATEMENT OF ROSS E. WALES, PRESIDENT, U.S. SWIMMING INC., AND GENERAL COUNSEL FOR U.S. DIVING, INC.

Mr. **Wales**. Thank you. Thank you, too, for the opportunity to speak to this bill.

Although I have been involved in amateur swimming for about 26 years, it was not until after I had competed in the 1968 Olympics that I realized the value of the work of volunteers and volunteer organizations. It is the time and money that those people spend to teach, coach, officiate, and administer sports that makes our Olympic effort what it is.

I believe that Congress recognized the value of volunteer help in 1976 when it followed the recommendation of President Ford's Commission on Olympic Sports to more clearly state that organizations promoting amateur sports both nationally and internationally should qualify more clearly for section 501(c)(3) treatment.

However, Congress concern about social clubs resulted in the proviso that the legislation before you seeks to eliminate. Really, it was a proviso intended to eliminate, I think, an imaginary problem. In fact, it created a greater problem.

There are numerous national governing bodies that have been made autonomous by the positive effects of the Amateur Sports Act of 1978. However, those organizations either cannot get tax exemption because of the wording of the proviso or they can get exemption only if they are willing to abide by an irrelevant restriction. As a result, some organizations must send athletes into competition ill-equipped to compete with the rest of the world.

I cannot impress upon the committee enough the problems that this proviso has caused. In my own sport of swimming it has been a minor problem because the only piece of equipment that we have are swimsuits—relatively inexpensive. The sport of luge has expensive equipment and expensive facilities. That organization has, therefore, chosen to forego tax exemption because of the need to provide expensive equipment to its athletes.

The sport of diving, also a minor expense from an equipment standpoint, applied for exemption in May of 1980, but their application, like many others, has been held in suspense by the IRS. As a result, it has lost potential life members, it has lost contributions. In fact, it has lost volunteers who used to be able to deduct their out-of-pocket expenses.

Diving's president has told me within the last week that he feels that his organization has lost all momentum that they had gathered as a result of the Amateur Sports Act of 1978. Revenues are way down for diving and even corporate sponsors have expressed a wait-and-see attitude because they want their corporate contributions to go to 501(c)(3) organizations.

House bill 4990 would eliminate these problems and I would like to thank Representatives Vander Jagt and Guarini for introducing it. I am pleased that the Treasury Department supports the bill. However, I am aware of their concern regarding the possibility of the wealthy parent who might be able to take a deduction as a result of a contribution, say, to a diving team that the individual taxpayer's daughter might compete on.

I am unfamiliar with anything in the present Tax Code that would so penalize a taxpayer for a relationship to a tax exempt organization. It seems to me that if an organization is not worthy of tax exemption it should be denied charitable classification.

If it is worthy for tax exemption, anyone should be able to contribute to it. In that regard I would say that I don't believe that anyone here is interested in disrupting the rule of quid pro quo, but we would appreciate, or at least I would appreciate, a deletion of the $500 limitation that is presently in House bill 4990.

I want to emphasize that we are not talking about a substantive change in the tax law, just a technical clarification to what I think everyone intended in 1976 and I would therefore ask that House bill 4990 be passed as soon as possible.

[The prepared statement follows:]

STATEMENT OF ROSS E. WALES, PRESIDENT OF UNITED STATES SWIMMING INC., AND GENERAL COUNSEL FOR UNITED STATES DIVING, INC.

Mr. Chairman, I am Ross E. Wales, President of one National Governing Body ("NGB"), United States Swimming, Inc., and general counsel for another, United States Diving, Inc. My law firm has represented numerous sports organizations in their applications for tax-exemption. Each of those organizations has had problems resulting from the unfortunate language of section 501(c)(3) of the Internal Revenue Code. These problems were not anticipated by the Congress when it modified the statute in 1976 to specifically include organizations which foster national or international amateur sports competition. Public Law 94-455, Section 2702.

Congress intended by its 1976 amendment to clearly provide exemption for amateur sports organizations, regardless of whether they were "educational," the term relied upon by some athletic organizations for exemption prior to the amendment. At the same time, Congress intended to prevent the allowance of tax exemption benefits for social clubs. The language used to supposedly disallow only social clubs, "(but only, if no part of its activities involve the provision of athletic facilities or equipment)", goes far beyond just social clubs. That language brings within its reach the very organizations Congress was trying to help and forces those organizations to become less effective in order to obtain the tax exemption they deserve. While I agree that social clubs should not be able to obtain exemption just because they may be athletic, the

1976 amendment applies more to national governing bodies than to social clubs. Although the legislative history states that the 1976 amendment was "not intended to adversely affect the qualification for charitable tax-exempt status or tax deductible contributions of any organization which would qualify under the standards of existing law," in fact the IRS has refused to follow this intent in light of what it perceives to be the clear language of the statute.

The proviso added in 1976 has placed the organizations responsible for developing our national programs in the Olympic sports on the horns of a dilemma: either they forgo tax-exemption or they fall short of their legal responsibilities. The Amateur Sports Act of 1978 gave to each national governing body the authority and responsibility to serve as the coordinating body for its respective sport, including the development of interest and participation, and the selection and supervision of a national team. To fulfill their obligations, most NGBs would like to provide training facilities and quality equipment for their National Teams, as well as providing facilities and equipment to developing athletes. Unfortunately, whenever an NGB takes youngsters to a training camp and lets them use its facilities, or whenever it sends a team into international competition with the best equipment available, the IRS interprets that as the providion of athletic facilities and equipment.

The national governing bodies for the sports of Swimming, Water Polo, and Synchronized Swimming have obtained tax exemption in the last couple of years but only after they agreed with the IRS that they would not provide athletic equipment or facilities to their member athletes. In other words the United States Swimming Team that competed against the Russians last August could not wear a team suit, and the U.S. Water Polo Team members that competed in the World Cup in Long Beach last year had to bring their own balls to practice. I can assure the Committee than an inordinate amount of lawyers' time has gone into the issue of what these NGBs can and cannot do to produce a first-rate program and national team within the confines of the proviso in section 501(c)(3).

United States Diving has been stymied by the 1976 amendment nearly two years ago, applied for tax-exemption nearly two years ago, but its application has been placed in suspense because of confusion created by the language of the 1976 amendment. It is unable to accept tax-deductible contributions, nor advise its officials and administrators that their out-of-pocket expenditures for the sport can be deducted, as are those of millions of volunteers who work for other charities. In addition, Diving has commitments from many individuals who wish to become life members of the organization, as soon as their $1000 contribution can be considered tax deductible. While this sum may be quite small with regard to the federal treasury, it is a very significant sum to an NGB that captures a disproportionately large number of medals for the United States at the international level.

Another example is the United States Luge Association, which has not yet decided to apply for tax exemption because it would create more hardship than it is worth. Few people are aware of Luge in the United Sates, and few people have even seen a luge run or a luge sled. The equipment in this sport is very expensive, and if the NGB continues to rely upon the finances made available to it in the past to develop the sport, we will continue to take no medals in international competition in Luge. The best way to develop a broad participation in the sport is to introduce youngsters to the sport at schools and recreational facilities. In fact this is what the organization does; by taking equipment to schools and allowing children to see and to use the equipment, the sport can attract interested participants, some of whom may later go on to become Olympians. Moreover, the National Luge Teams trains at facilities provided by the NGB in Lake Placid. Obviously this provision of athletic equipment and facilities means that the U.S. Luge Associticn cannot presently obtain tax exemption. As a consequence it is no doubt losing contributions, its volunteers are losing a benefit that other sports have, and the United States is bringing up the rear in international luge competion.

All of the NGBs that I have mentioned were, prior to the Amateur Sports Act of 1978, governed by committees of the old Amateur Athletic Union. The AAU was determined in the early 1950's to be an educational institution, and was therefore granted exemption under 501(c)(3) which continues. Contributions to the sports were deductible, as were officials' expenses in support of the sports, and the sports themselves did not worry about having to file tax returns if their revenues exceeded their expenses in any particular year. Although the Amateur Sports Act permitted these sports to become autonomous, supposedly in the name of helping the sports, it is the sports which cannot obtain the benefit of tax exemption.

House Bill 4990 would eliminate the dilemma for NGBs. The Bill would remove all reference to the provision of athletic equipment and facilities with regard to tax exemption of an organization organized to foster national and international athletic competition under section 501(c)(3), but would take into specific account differences between various sports organizations. The general rule would be to disallow any deduction for contributions made under section 170(c) to any such organization that provided athletic facilities or equipment to the contributor's family members. Excepted from this rule would be contributions to the United States Olympic Committee and to NGBs, contributions of less than $500 per year, and out-of-pocket expenses incurred by a non-athlete who renders service to such an organization.

The only fault with House Bill 4990 as it is presently drafted, I believe, is the restriction against deductible contributions to organizations that provide athletic equipment or facilities to the taypayer's family members. Every NGB has among its membership clubs which really perform an educational service, by teaching youngsters the fundamentals of sport, as well as discipline and sportsmanship. There are many such member-clubs of United States Swimming, for example, that received their tax-exempt status prior to the 1976 amendment; every club which has applied since that time has been denied tax-exemption. Contributions to such clubs should be deductible, regardless of whether the taxpayer's family is a participant in the club's program. After all, my contribution to a charitable museum, zoo, or library is deductible, regardless of how often my family visits.

I agree with the intent of the Congress in passing the 1976 amendment to section 501(c)(3). I do not believe, however, that Congress' intent has been served. I believe that House Bill 4990 more effectively achieves that intent than did the original amendment and I would therefore strongly urge that legislation be passed as soon as possible so that Congress' original intent can be satisfied, and so that the organizations that prepare our athletes for the Olympics can concentrate on that task.

Chairman STARK. Thank you very much. Who do we have next here? The other prepared statement that we have is Mr. Cohen's. We will make that part of the record, Mr. Cohen, and you may proceed in any manner that you see fit.

STATEMENT OF STEPHEN B. COHEN, CHICAGO, ILL.

Mr. COHEN. Members of Congress and this committee, ladies and gentlemen, I thank you for the opportunity of being here today and testifying, not as a representative of any one sport, but as a private citizen and one interested in all amateur sports at a local level.

While I do represent, pro bono—and I emphasize pro bono—several speedskating organizations in the United States, it should be noted that the Northbrook Speedskating Club, my place of residency and the speedskating capital of the world, has obtained 501(c)(3) status.

Mr. STARK. Excuse me, when did West Allis, Wis., lose that?

Mr. COHEN. I am glad you raised that issue, Mr. Stark, because it gives me an opportunity to point out that West Allis, Wis., operated on one generator this year, the only outdoor refrigerated rink in the United States that is operational, whereas a country like the Netherlands, whom we must compete against, the size of Rhode Island, has 11 refrigerated outdoor rinks.

Our national organizations don't have the money. Our local organizations can't raise the money. And because of bills like the one currently in existence, there is currently not even the opportunity to even try and raise the money.

Mr. Stark, the Northbrook Speedskating Club was lucky. They had a law firm that was willing to go to bat for them and spend approximately $25,000 of actual time—not billed, but time—in order to file a case in the U.S. Tax Court after a refusal to recognize the club as a 501(c)(3) organization.

Yes, we did prevail. The diving organization has not pursued that approach. Other speedskating clubs in the United States have not had the opportunity to proceed in the Tax Court. They don't have the resources and they haven't had anyone volunteer to help them. Some of us are now making that effort.

I must support with all sincerity the deletion of the "facilities and equipment" language from 501(c)(3). However, I cannot understand any limitation on the aggregate amount of contributions being part of this bill.

I think of it as a step backward. I think it will handicap our local organizations. The very foundation of amateur sport in this country cannot be handicapped by a qualified contribution limit on those who support these organizations. As was said before me today, these local organizations many times derive their benefits from a single or a few benefactors who can afford to make a contribution. Those benefactors may in fact have someone competing in that club, but they will go on year after year after year making the same kind of contributions because of their love of the sport.

To give you an idea, the Chicago Sun Times on Monday, February 16, 1976, wrote an article on Ed Rudolph, the former U.S. Olympic speedskating coach. It ended as follows: "Men like Ed Rudolph never get old. They never learn how to take it easy. They just go on giving of themselves without asking for anything in return. They don't grab the headlines and their life stories don't make best-selling books, but they do make the world a better place to live."

It is the local amateur athletic organization in this country—be it figure skating, be it luge, be it speedskating, be it gymnastics—you name it—it is these organizations that support our national and Olympic sports in this country.

Mr. Hough emphasized that it costs a lot of money to participate in rowing. Others have indicated that it costs money to participate in other sports. I can only tell you that having three children who are speedskaters today—one who is a national level competitor at the age of 9—that you can't imagine the cost of keeping up an amateur athlete in this country.

Yes, I believe that unreimbursed expenses of amateur athletes who are competing on a national or international level should also be deductible. However, that is not part of this bill, but something that this committee should consider.

On the other hand, the deletion of the aggregate $500 limitation should not go the way Treasury wants it to go, to a $200 level, but it should be eliminated altogether. The deletion to the principal part of the bill should be accepted and I support that wholeheartedly for all amateur sports organizations in the United States.

Thank you very much.
[The prepared statement follows:]

STATEMENT OF STEPHEN B. COHEN, CHICAGO, ILL.

Honorable Members of the United States Congress, ladies and gentlemen: My name is Stephen Bruce Cohen. I am a practicing attorney and a partner in the Chicago law firm of Foss, Schuman & Drake and I am also a partner in the Indiana firm of Cohen, Cohen & Bullard, located in East Chicago, Indiana. I was born and raised in east Chicago, Indiana and graduated from George Washington High School in East Chicago. I have an A.B. degree from Harvard College, Cambridge, Massachusetts. A J.D from Vanderbilt University Law School, an LL.B. in international law from Cambridge University (Downing College), England, and a certificate in international law from the old schools, Cambridge University, England. As a result of parental guidance, I began competitive athletics at a very young age and have been a member of athletic teams which have competed at both a national and international level. In addition, when I was in law school, I formed the Nashville AAU Olympic Development Committee and promoted the first integrated trade and field program in the middle south. I have continued active participation in sports on a personal level and I am currently a director of the Northbrook (Illinois) Speed Skating Club. I am also pro bono counsel to the Alpena Speed Skating Club (Michigan); the eastern Minnesota Speed Skating Association (St. Paul); The Midway Speed Skating Club (St. Paul); the Northbrook Speed Skating Club, Inc. (Illinois); The Park Ridge Speed Skating Club (Illinois); the Bay County Speed Skating Club (Michigan); the Detroit Speed Skating Club (Michigan); the Iowa Speed Skating Association (Cedar Rapids); and the West Side Speed Skating Club (Cedar Rapids). I am donating my time to testify today in behalf of my pro bono clients and as a measure of public support by my law firm, Foss, Schuman & Drake, in order to provide as a public interest, its contribution to the furtherance of amateur sport in the United States.[1]

I am here today as a result of my long time relationship with the amateur world of sports and the inability for amateur sporting groups, other than the national organizations, to obtain tax exempt status under section 501 (c) (3) of the Internal Revenue Code. My first struggle with this problem arose during my law school days when I attempted to raise money to promote the first integrated track and field competition in the history of middle Tennessee. It took months for the Nashville AAU development committee to be recognized as a adjunct of the National AUU and then there were those who felt that contributions made to the Nashville AUU development committee might not be tax exempt. Without recognition that contributions to that program could be deducted for Federal income tax purposes, no money could have been raised for purposes of promoting the sport. Even at that time, the local organization provided such things as pole vault standards, high jump standards, a track to compete on, etc. However, it was not until my involvement in the sport of speed skating that I realized how much so few contribute, to quote the words of Ed Rudolph, the former olympic speed skating coach from Northbrook, "without asking for anything in return". Speed skating, like figure skating and other sports which have no competitive level in the high schools or the colleges of this country, must exist from the ground level to the point of national qualifiers (and even beyond) solely or primarily from contributions made by "A person, or by a member of the family of a person," who uses athletic facilities or equipment provided by their respective organizations.

The conference agreement to Public Law 94-455 prohibits the granting of an exemption to a "social club" type organization and indicates that the congressional intent of the "provision of athletic facilities or equipment" exception to 501 (c) (3) in solely for the purposes of denying the exemption in question to organization which were truely not legitimate sporting organizations fostering national and international amateur sport competition. Therefore, the initial deletion of the words "but only if no part of its activities involve the provision of athletic facilities or equipment" as proposed under H.R. 4990 introduced by the Honorable Mr. Vander Jagt and the Honorable Mr. Guarini is a step forward in helping to put amateur athletics in a position where they are financially viable.

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[1] A more complete biographical sketch of Stephen B. Cohen is attached hereto as exhibit "A" [omitted].

Mr. Cohen's remarks before this subcommittee should be construed as his opinion based upon his experience in dealing with 501(c)(3) exemptions to athletic organizations and should not be construed as a statement of any other party or organization regardless of his position as pro bono counsel.

However, the section 2 amendments to section 170 of the Internal Revenue Code, the amendment to section 3 amending section 2055 of the Internal Revenue Code and the amendment under section 4 amending section 2522 of the Internal Revenue Code are, without exaggeration, a step backward for amateur sports in this country and are likely to result in a demise of some amateur sports in this country not supported by public funds or national sporting organizations. In my opinion, the limitation on contributions allowed for a person and members of the family of the person making use of athletic facilities or equipment provided by an amateur sporting organization is totally incomprehensible, illogical and counter-productive. It is impossible for those involved in amateur sport to reconcile the commitments of our government to a strong and healthy youth with the policies, which when analyzed, serve as an systematic approach to self-destruction. One of the manifestations of this economic predicament has been the tendency to divorce the substance of our tax policy from its rhetorical presentation—the tendency of those who write our laws to rely on the efficacy of limited means to achieve unlimited ends. It was Harry Truman who said "There is no room for economic isolationism in a world torn between freedom and communist tyranny". Similarly, there is no room for the economic isolation of local amateur sports organizations in a world where our young people (and adults) must compete against the professionals of the Eastern European nations of the world. This country must meet its external challenges and it must recognize them in the international world of sports at a primary level. If Congress is to further handicap and shackle the financing ability of those who support amateur sport in this country, then Congress should be prepared to provide all of the national funding required to support amateur sporting organizations which cannot exist in this age without some incentive for private funding. It was Adlai E. Stevenson who said "The eagle, not the ostrich, is our national emblem". Let us not because of ill-conceived amendments to section 501(c)(3) of the internal revenue code allow the hammer and sickle to replace the stars and stripes in the field of international sport. The youth of this Nation are its most important natural resource. While it is important to delete that provision as set forth in section 1 of the Vander Jagt/Guarini bill amending section 501(c)(3) by striking the words "but only if no part of its activities involve the provision of athletic facilities or equipment" it would be a travesty and a disservice to the youth of this Nation and all amateur athletes to adopt the other amendatory sections of H.R. 4990.

I have been approached by more than one individual who has asked me how can congress provide the necessary language to the Treasury Department in order to avoid a misuse or improper granting of 501(c)(3) exempt status to organizations that are really "social clubs". Since I have worked with tax law specialist in the exempt organizations technical branch of the Internal Revenue Service, I am certain that there are those in that department who would agree that consistent language in the by-laws of an organization would be sufficient to weed out those organizations which have no active program fostering National and International Sports Competition. First, most organizations applying for 501(c)(3) status as sports organizations should be required to be affiliated with, either on an organizational level or through its members, the nationally recognized sports organization, controlling the amateur sport for national competitions and international competitions. Secondly, the organization should have a regular competitive program which ulimately leads to national qualifiers and international competitors. For example, the northbrook speed skating club, an organization that has probably, per capita, provided more international competitors than any other sporting club in the United States, incorporates in its purpose clause of the by-laws of said organization in part the following: "The Northbrook Speed Skating Club is organized exclusively for charitable . . . purposes . . . that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code . . . . In furtherance thereof, the purposes of the corporation are to instruct and train boys and girls and men and women in order to develop and improve their capabilities in the amateur sport of speed skating; to encourage participation in the amateur sport of speed skating and by so doing combat juvenile delinquency; and to foster national and international amateur speed skating".

It is not difficult to paraphrase such a purpose clause in order to avoid implications that arise as a result of some group attempting to obtain an exempt status qualification where the principal function of the organization is to have Wednesday night bingo games and an occasional softball game. Ladies and gentlemen, we are here in a serious vein. We are not attempting to be destructive we are seeking a constructive approach to a problem that plagues amateur sporting groups who foster national and international competition. It is the competitors themselves who not only devote their time and energy but all of their available resources in order to represent "you" and to bring honor and prestige to this nation as well as self-satisfaction for themselves as a result of their hard-earned athletic achievements. We must not allow them to be penalized because of an amendment to the Internal Revenue Code that seeks to help our major national sports organizations and our olympic organizing committees without adequate consideration of those organizations who need help the most.

Many sports organizations have been granted a 501(c)(3) exemption because they act in a capacity as an educational organization and help to combat juvenile delinquency. Even the approach to combating juvenile delinquency has been met with strong resistance by the Treasury. Without any logical basis, Treasury has denied an exemption to organizations such as the Northbrook Speed Skating Club, because, while the organization certainly helps to "combat juvenile delinquency", it has too many "adult" members. I ask you whether or not Treasury has any standards for such a ruling and I will answer the question myself—the answer is no. Unfortunately, when dealing with sports organizations Treasury has imposed unreasonable guidelines which are inherently unfair and arbitrary. Based upon my personal experience, Treasury's treatment of amateur sporting organizations is abusive and capricious and is unsupported in the law and lacks uniformity in its application. As a result of the 1976 amendments to section 501(c)(3), which amendment was intended to prevent social clubs from being recognized as tax exempt 501(c)(3) organizations, Treasury has indiscriminately used that language (which is proposed to be deleted "but only if no part of its activities involve the provision of athletic facilities or equipment") as a basis for failing to make a written determination on the application for tax exempt, charitable status under I.R.C. 501(c)(3) and has orally refused to act favorably on the applications of hundreds and, if what was told to me by the former chief counsel for the Internal Revenue Service is true, thousands of applications for 501(c)(3) status by amateur sporting organizations. I agree with the Honorable Guy Vander Jagt of Michigan when he said, and I quote from the Congressional Record of November 16, 1981, ". . . a [t]here are currently pending at the Internal Revenue Service approximately 150 applications for tax exempt status by various bona fide sports organizations which requests the IRS will probably be required to deny unless corrective legislation is enacted." "Without tax exempt status many of these organizations are unable to raise the funds necessary for their existence. This will affect severely our ability to field a strong olympic team in 1984. It is vital that Congress enact this corrective legislation this year."

Regardless of my agreement with this statement of Congressman Vander Jagt, I do not believe that Congressman Vander Jagt or any other member of this committee has had the opportunity to review the applications which are pending for tax exempt status under section 501(c)(3). I suggest that the vast majority of those applications are from local amateur sporting organizations which are the foundation for the development of our young people who later achieve and are actively participating in national and international sports activities. Regardless of your preference, there are speed skating organizations, figure skating organizations, swimming clubs, field hockey clubs, track and field organizations, ski clubs, summer basketball associations, rowing organizations, bob sled organizations, luge organizations, equestrian organizations and many others who must be in a position to qualify for exempt status under section 501(c)(3) if they are to continue to exist and provide the competitive opportunities for our young people to achieve their prominence in the world of international sports.

While I have made specific comments regarding the efficacy of H.R. 4990, I have attempted to be very general in my application of the needs of amateur sports. However, I do have a particular interest in the survival of both pack style and olympic style (metric) speed skating in this country. Many articles have been written on this sport and the dedication of its participants. In comparison to basketball, speed skating is not a highly popular sport. However, in places such as Northbrook, the Metropolitan Chicago area, the greater St. Paul area, the Milwaukee area, the Madison area, Albany, New York, Saratoga Springs, New York, Pittsfield, Massachusetts and other hot beds of speed skating, there is a growing need for additional financial support where a high inflation factor has become an impediment to continual advancement and achievement by those who participate. The success of local programs is directly related to strong parental and family support. The Northbrook Speed Skating Club is totally family run (parents of present and past skaters). The success of olympic skaters like Leah Poulos-Mueller, Ann Henning, Diane Holum, Nate Blatchford, Edward Rudolph, Sally Blatchford, Beverly Burr, and Greg Lyman are a direct result of the parents and families who provided financial support and psychological encouragement to these young athletes. There are no, or very few, coaches who receive any financial remuneration as a result of helping these young people. It is men like Sam Poulos, the father of Leah Poulos-Mueller, who as a result of their love of the sport, continue to coach and aid our young people. There is no other sport that I can think of, and I have participated in many, that creates a greater feeling of need between parent and child than the sport of speed skating. To experience it is to know it. I am sure that there are other programs such as figure skating, gymnastics, bob sledding, cross-country skiing, bicycling which require a similar type of parental support for success. I ask you as members of Congress and the representatives of the people of this country, how you can attempt to limit the deduction for contributions made by the participants of amateur sporting organizations or limit the contributions made to amateur sporting organizations or in support of the members of those organizations by the parents and family of those who represent you, me and all of us.

Please adopt the change in section 501(c)(3) which will delete the oppressive language "but only if no part of its activities involve the provision of athletic facilities or equipment" and such similar language as it appears in section 170, section 2055, and section 2522 of the Internal Revenue Code. However, in good conscience, do not adopt that part of the proposed H.R. 4990 which would limit the deductibility of contributions to or for the use of an organization organized and operated exclusively to foster national or international amateur sports competition if such contribution is made by a person, or by a member of the family or a person, who uses any athletic facility or equipment provided by such organization. The exception denying a deduction only for contributions in excess of $500.00 in the aggregate made in any taxable year, while a small token of support for local organizations, does not come close to providing for the need of our amateur sports organizations in this country. Such an artificial, capricious and arbitrary limitation would be damaging to the youth of our nation and may result in the total elimination of many already crippled athletic organizations in this country.[2]

Mr. GUARINI [presiding]. Thank you. Are there any questions?

Mr. COUNSIL. I would like to testify.

Mr. GUARINI. Are we asking the questions after the panel has all made their statements? Is there a Mr. William Lehrfeld here?

Mr. Counsil, would you make your statement now, then, sir?

STATEMENT OF ROGER COUNSIL, EXECUTIVE DIRECTOR, U.S. GYMNASTICS FEDERATION, FOR THE U.S. OLYMPIC COMMITTEE

Mr. COUNSIL. My name is Roger Counsil and I am executive director of the U.S. Gymnastics Federation. We are the national governing body in the United States for the sport of gymnastics, as mandated by the U.S. Olympic Committee and by the Federation of International Gymnastics, with its headquarters in Europe.

I would like to take a brief moment to apprise this committee of the kind of activities of the national governing body. Not only do we assemble the USA gymnastics teams for Olympic Games, Pan American Games, world gymnastics championships, and many other similar competitions, both national and international, we also perform many other functions, such as training camps, rule-making and enforcing, clinics that instruct, communication with our constituency via two magazines, the training of officials, supplying of teams with competition apparel and support, and support of scheduling for travel for competitions.

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[2] Another example of the deplorable condition of some amateur sports in this country is, again related to speed skating. In the Netherlands, a country the size of Rhode Island, there are 11 refrigerated outdoor Olympic size speed skating ovals. In a country with our vast resources and unquestionable wealth, the only operating facility of that type is located in West Allis, Wisconsin. One generator has broken down and the Department of Natural Resources in Wisconsin was unable to fund sufficient monies to repair the broken generator. The refrigeration of the Lake Placid facility has remained idle since the last Olympic games due to a lack of funding. Park districts and forest preserves in the Chicago area do not have the manpower nor the equipment, in most cases, to even scrape natural ice in order to provide a good or reasonable facility, weather permitting, for our young people to train. A limitation on the amount of contributions made by families of competitors would make it impossible, I believe, for the Illinois speed skating clubs to achieve the ability to privately fund, if public funds cannot be found, the construction of another Olympic size speed skating oval in the northwest Chicage suburban area to support the approximately 500 to 1,000 speed skaters who must travel on a daily basis to West Allis, Wisconsin (a 150 mile round trip) in order to achieve a modicum of success in their effort to eventually represent this country in the Olympic games and other world competitions.

Legal note.—Members of Congress are urged to review *Lyons* v. *Associated Drag Strip*, 64-1 U.S.T.C. 9283 and Revenue Ruling 65-2, 65-271 and 77-365 in order to familiarize themselves with situations which lend themselves to an exemption being granted to organizations with a purpose clause similar to the Northbrook Speed Skating Club.

Our annual budget for 1981 was $1,930,000, and the demands for our services are rapidly increasing. Sport is indeed an expensive business. A recent independent survey has identified 10.8 million people in the USA participating in some level of gymnastics. Formally, our membership is 150,000. We are still not reaching nearly all of the people who are dedicated to our sport.

The problem as it affects the U.S. Gymnastics Federation, simply stated, is the existing 501(c)(3) tax laws for tax exempt organizations which affect amateur sports national governing bodies. Those bodies cannot, under the present interpretation of that law, provide facilities or equipment for the athletes on our national teams.

Just as great a problem is that eight of these national governing bodies for sports cannot receive tax exempt letters from the Internal Revenue Service until such time as the wording of the 501(c)(3) tax law is modified. This in effect prevents the sports governing bodies from seeking financial assistance through donations and grants in order to help fund those sports for athlete development and competitions.

With today's spiraling expenses it is nearly impossible for a national governing sports body to balance its budget without financial support from the business and industrial community as well as from private citizens. In order to prepare our athletes for the 1984 Olympic Games in Los Angeles, and those Olympic Games are rapidly approaching, we need to optimize our potential to field the strongest Olympic team possible.

Gentlemen, I urge your support of H.R. 4990 so that our American athletes will not be thwarted in their efforts to excel in Olympic and other similar competitions. Thank you.

Mr. GUARINI. Thank you, Mr. Counsil.

Failure to pass a bill like this would restrict our competing, Mr. Counsil, considerably with the foreign countries whose athletic programs are so adequately staffed and funded?

Mr. COUNSIL. Yes. In my prepared statement I mentioned that in Canada approximately 7 percent of funding of sports comes from the Federal Government. In the Eastern bloc, of course, we all know that sports are almost totally funded by government.

We are not advocating this, quite obviously, because that is not the American way. But we do feel that the present dilemma that we are experiencing seriously hampers us in seeking financial support.

Mr. GUARINI. A few years ago I had the opportunity of going behind the Iron Curtain and visiting the Olympic training camps that they have, and I can attest to the intensity of their effort and the amount of money that they have spent and the type of gymnasiums that they have acquired and the efforts that are made that are so much more involved than what we ourselves are putting forth in our own country.

certainly feel that something should be done and this is only a small step forward. There has been talk about even hopefully having a checkoff box so that people could voluntarily contribute to the Olympics so that our people could be put on a par with the rest of the world and I wholeheartedly subscribe to that. I would like to see something like that happen so that all Americans can contribute their $1 or whatever, which would really be a great measure of support from the entire American public.

That is a little ways down the road, but it is being talked about on the Hill.

I would like to ask Mr. Duncan if he has any questions to ask.

Mr. DUNCAN. Do you know the names of any organizations that have been hampered by the current restrictions on providing athletic facilities and equipment?

Mr. COHEN. Yes, sir. I can name virtually every speedskating organization in the United States, Mr. Duncan, and I can tell you that this year, the first year when the Northbrook Speedskating Club had tax exempt status, we were able to double the amount of money we were able to raise in an effort to help send some of our kids to Europe to train and compete in international competition as well as on a national level.

This makes a big difference in any kind of a local sport. You have to understand that even in a club like the Northbrook Speedskating Club, which I am a director of, in 1 year in the last couple of years we have had at least three or four members of the United States indoor team, at least 10 or 11 or 12 members of both the national indoor and outdoor team, and it was all paid for by local funds, not one dime coming from national organizations.

That is why not only is this important for national organizations, but the limitation placed on the amount of contributions for local organizations is a severe handicap when you consider what the cosponsor's impressions were in Russia, where there is no limitation and the Government pays for everything.

Mr. DUNCAN. Thank you very much, sir. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. GUARINI. Mr. Moore.

Mr. MOORE. No questions.

Mr. GUARINI. There has been talk about $200 or $500. May I ask you gentlemen where, knowing the inflation rates and knowing the high cost of equipment and training costs there are today, where would you put a fair figure for a family that wants to support a competitor in the Olympics or some other athletic event. $200 doesn't seem to go very far these days, as testified to by the Secretary of the Treasury.

Could I ask you gentlemen how much you think would be more in line?

Mr. HOUGH. I am not sure that any limitation really fits the problem. In other hearings it was suggested that the problem that Treasury is attempting to deal with could be dealt with in conference by some other arrangement of fencing out the few instances of abuse that they are most concerned with.

I think that issues relative to the club size that is involved in receiving the gift and the number of competing athletes apart from the son or daughter would be a more effective way of dealing with this issue. As has been pointed out this morning or this afternoon, there are a lot of instances where one or two major benefactors in the community become the source of not only current but ongoing support for an active program.

In my own sport, in the city of Philadelphia, where there is a series of boathouses along the Schuylkill, virtually every one of them has two or three major benefactors who, year in and year out, are donating equipment. Equipment donations must amount, in this day and age, to $10,000 or $12,000 a year to keep 50 or 60 boys competing.

Now that donation source would be cut off because there happened to be a son or daughter, and I believe the language in the proposal doesn't limit it to be a son or daughter, who is at an international level of competition. It could be a son at age 6 that continues on in the sport through to the age of 27 where the father has really enjoyed seeing the club sport progress and wishes to continue to support it and now can't. At least he can't get any tax deduction.

So I am not sure that you can deal with the issue in that manner, but I think the Treasury Department's concerns might be dealt with through some other means.

Mr. **Guarini**. Are you concerned that there have been abuses of unreimbursed expenditures?

Mr. **Hough**. I don't have that concern because the objective that I am most supportive of is facilitating, without direct Federal support, the preparation of our best athletes, and in the instances that the Treasury cites it was clear that we received the end result, which was the better preparation of an athlete.

Now they are concerned that there was some form of impropriety in their mind, and I am not too familiar with it. But I don't think in my own sense of propriety that there was anything that was an abuse.

Mr. **Guarini**. Well, with inflation and high costs today, is the problem of supporting athletes in competing in the Olympics, internationally and nationally, worsening? Are the contributions keeping up with the level of the high costs or are we really in need of some legislation that even goes beyond this legislation here in order to get a sufficient basis of support for our athletes.

Mr. **Wales**. That is a pretty big question. Let me see if I can break it down. There are some sports—and, of course, the U.S. Olympic Committee—which are tax exempt right now, some of them only with provision that they will not provide equipment and facilities and their financial structure could be better, but they are surviving.

There are others, some of the national organizations, that have not been able to achieve tax exemption, and among those, for your information, are the sports of diving, track and field, volleyball, rollerskating—I believe there are some others as well—that have not been able to get tax exemption.

One organization that I represent, U.S. Diving, used to have a kitty of about $100,000 that it could fall back on. Its kitty is now about one-fourth that size and it believes that the sole reason is it has been, for the last 3 years, its inability to obtain tax exemption.

There are other ways to help amateur sports. I think this is such a basic one and I would like to get this one passed and then we might talk about others.

Mr. GUARINI. Well, are we talking about the lack of cooperation or understanding of the IRS in meeting the problem?

Mr. WALES. I think the IRS has tried to deal with a very difficult problem created by the languge that was far too broad in 1976. There is legislative history, I think, that permits each and every one of the organizations that have applied to achieve exemption because the 1976 legislative history said we don't mean to restrict in any way those organizations that could be exempt under the law before we added this.

However, the IRS, I think, rightfully looks only at the language, which is very clear, and therefore not to the legislative history to say well, either you do or do not provide athletic equipment and facilities and if you do we cannot give you tax exemption.

The confusion, I think, is very understandable.

Mr. GUARINI. Mr. Cohen, would you like to comment on that?

Mr. COHEN. Yes. I would like to comment on that and point out in the city of Minneapolis this year Lake Nakomis completely closed down because of the lack of funds from the city of Minneapolis and no support from local speedskating clubs. The city of St. Paul charged Midway Speedskating Club $4,500 as a flat fee to prepare natural ice. The clubs at Mount Prospect, Northwest Pierce, and Champaign in Illinois have virtually died as a result of lack of funding.

The Northbrook Speedskating Club's cost for indoor ice alone, just for indoor practice has risen approximately 25 percent, 30 percent over the last year and 25 percent over the year before that. So when you are talking about have the donations kept up with the cost, the answer on the local level is absolutely no.

We need an infusion of capital into the infrastructure. We are faced—and I think we can't lose sight of the forest for the trees, one, an Olympic Committee that supports primarily Olympic sports; two, national sporting organizations; three, industrial leagues in certain sports like basketball; four, colleges; and five, high schools and your grammar schools—all supporting certain phases of sport in this country. But sports such as figure skating, sports such as speedskating, luge and other similar types of organizations have absolutely no local support or involvement in the infrastructure that I have just mentioned.

These young people are being kept off the streets. There is more to sports than just competing in a track and field meet as some of us have done. There is an education to be derived. There are experiences that will carry these kids through life. You are dealing with the youth of this Nation and anything we can do for them will be a help.

Obviously this bill I support wholeheartedly. I do not think it goes far enough. I think we must eliminate the $500 limitation on contributions entirely.

I think the more that we can get, the more possibility there is for a young person in this country to achieve—and it might be only one. It might be a Diane Hollum. It might be an Ann Henning. It might be an Eric Heiden. But when these young people shine in the limelight of international sports, there is nothing that any country in the world can do to diminish that, and, if that is what we are doing here today, then I say the bill doesn't go far enough and I agree with you, Congressman, we should do more.

Part of that is to help find a way to take care of the unreimbursed expenses of the competitors themselves. Obviously we need the volunteers, as in diving, as in other sports. You can't operate any competition without judges, without people that are standing there, and I want you to know, if you have ever stood outside and timed a speedskating meet in 45° below zero weather and somebody says that that is an abuse, because you take a deduction for your travel expenses, then tell them to go do it themselves.

Thank you.

Mr. GUARINI. Thank you, Mr. Cohen. If there are no further questions, I would like to thank the panel for the great work that they are doing with our youth and for the contributions that they have made and how important it is for the success of our athletes. I want to assure them that they have a great deal of support for their good work and endeavors and I think we will be able to find some solutions.

Unfortunately, we are at such a disadvantge, being such a wealthy nation, with the other countries that put, as a national effort, their best foot forward for their athletes and I think that there is a tremendous amount of national pride that all of us feel when our athletes do well in international competition and for the public interest and for the sake of the deep sentiments that we have for our country and our flag, that we really ought to do more and put a stronger effort forward in helping our young athletes and I want to thank you for the help that you have given this committee.

Thank you very much.

Mr. COHEN. Thank you.

Mr. GUARINI. On H.R. 3191, to amend the Internal Revenue Code of 1954 to exempt conventions held on cruise ships documented under the laws of the United States from certain rules regulating foreign conventions, I would like to call forward Frank Drozak——

Chairman STARK. Who introduced that bill, Mr. Chairman?

Mr. GUARINI. Mr. Chairman, I welcome you back.

Chairman STARK. This bill we are about to have hearings on was introduced by Mr. Guarini of New Jersey, I believe. Is that right?

Mr. GUARINI. I have heard of him. Perhaps you may want to call the rest of the panel. I was just in the middle of doing that.

Chairman STARK. If all the members of the panel would like to come forward at this time, those of you who are on the witness list—Mr. Drozak is here and if Mr. Luciano and Mr. Everhard and Mr. Thune are with us, why don't you come on up.

I want to thank you all for your patience as we have juggled the schedule around today trying to accommodate Members of Congress and the committee who drop in between debating on the floor and other committee hearings. You gentlemen have been most patient and most cooperative.

You are here to testify on a bill that has been introduced by Mr. Guarini and, as a matter of fact, I have been asked by Congressman Heftel to indicate his support for this bill. He was unable to be with us today at the hearing and he wanted me to make known that he has supported this, along with many other Members of Congress, and I am sure you were all here when my colleague, Mr. Guarini, so elegantly defended your industry.

You have all presented prepared testimony. If you would like to summarize, we will make your prepared testimony part of the record, but I obviously would appreciate your explaining to me how long a yacht has to be before I can charter it for my business meeting and not have it excluded.

Mr. Drozak, would you please proceed in any manner you see fit, and then we will go right down the panel. Thank you, gentlemen.

STATEMENT OF FRANK DROZAK, PRESIDENT, SEAFARERS INTERNATIONAL UNION OF NORTH AMERICA, AND PRESIDENT, MARITIME TRADES DEPARTMENT, AFL-CIO

Mr. **Drozak**. Thank you, Mr. Chairman. First of all, I would like my statement to be entered in the record.

Chairman **Stark**. Excuse me. Would you pull that microphone right up close because otherwise it is almost impossible to be heard in this room unless you talk right at it.

Mr. **Drozak**. Thank you very much, Mr. Chairman. I would like my statement to be entered into the record.

Chairman **Stark**. Without objection, Mr. Drozak.

Mr. **Drozak**. I would like to make some comments to add to this statement. First of all, I have listened very carefully to the Secretary of the Treasury this morning outlining his comments in opposition to this bill.

It confuses me, Mr. Chairman and committee members, that while this administration is on record to give incentive to industry to create jobs for the unemployed in this country, one of the most distressed areas is the maritime industry, which again the administration is on record as supporting, legislation both in the Senate and in the House to attempt to revitalize this industry, that he would testify in opposition to this bill, which would create thousands of jobs, in my opinion, for unemployed in this country and the maritime industry today.

These cruise ships will represent some 900 jobs. For the 900 jobs on 1 ship, for each job on board the ship it represents 100 jobs ashore, so we are talking about a lot of jobs this industry is creating.

Two, I listened to Mr. Vanger Jagt this morning when he mentioned that foreign ships should be included or foreign countries. Well, sir, they have their own tax breaks and incentives as far as foreign passenger ships are concerned by their own countries.

I believe this tax relief would enable the American steamship companies, and particularly the American worker, an opportunity to attempt to be halfway competitive but not all the way competitive to those foreign competitors there.

Two, when we mentioned Canada and Mexico and Jamaica as being given tax relief it just bewilders me that we people in this country are being discriminated against in favor of Canada, Mexico, and now Jamaica in order to build their economy and to encourage tourism and conventions to their countries and leaving the American people and American operations with no alternative but to close its doors.

Mr. Chairman, it was in the 1970's when the passenger ships went out of business. It was actually in 1968 when they began. It was some of these things with many other issues that created that problem. But on behalf of management and labor, we have analyzed very thoroughly the tourism business and we believe between both parties we have put together a workable solution that would enable us to bring back the American-flag ship to this country again.

Without this tax relief and without being allowed to solicit conventions on board these ships which, in my opinion, is the best place to have a convention—as you said, I believe, you are pretty well locked in; unless you can swim pretty good you won't get away—and you certainly can conduct a lot of business.

Both with the *Delta Queen*, the *Mississippi Queen*, the *Independence*, and the *Constitution*, they are on a 3- to 7-day trip. Most conventions last that long. You can certainly conduct good business.

I would suggest, Mr. Chairman, in closing on my remarks that the Treasury Department might try to solicit one of these ships to hold one of their meetings on and maybe they could see some of the issues that confront us and they could get down to business instead of being at some of these hotels and playing golf all the time.

So I would urge the committee, Mr. Chairman, to certainly support H.R. 3191 and I appreciate the opportunity to testify here before your committee. Thank you very much.

[The prepared statement follows:]

STATEMENT OF FRANK DROZAK, PRESIDENT, SEAFARERS INTERNATIONAL UNION OF NORTH AMERICA, AND PRESIDENT, MARITIME TRADES DEPARTMENT, AFL-CIO

Mr. Chairman and Members of the Subcommittee:

My name is Frank Drozak and I am President of the Seafarers International Union. I am also President of the AFL-CIO Maritime Trades Department, representing eight and a half million workers in forty-three affiliated trades. We appreciate this opportunity to share our views on H.R. 3191, a bill that would set straight a problem that was caused by earlier legislation.

Over the past decades, the U.S.-flag passenger industry had all but died. We have been very active in pursuing efforts to revive this important sector of the fleet. We believe that H.R. 3191 would help in that revival.

As you know, PL 96-608 changed the Internal Revenue Code with regard to tax deductions for convention attendance. Specifically, it disallowed deduction of expenses for attending conventions held on passenger ships. H.R. 3191 would amend the law to allow for the deduction of such expenses aboard

U.S.-flag ships operating in North American ports. We think that this bill is both fair and timely.

Over the past two years, Congress passed legislation that was intended to revive the U.S.-flag passenger fleet. As a result of that legislation, the Oceanic Independence is operating as a cruise ship in the Hawaiian Islands. The SS Constitution will soon be returning to service in the same trade. There are 900 jobs at stake with just these two ships.

The future success of the U.S.-flag cruise industry depends on its ability to attract new business. Convention business is an obvious area for development. Without an allowable tax deduction for convention expenses on U.S.-flag cruise vessels, it is extremely doubtful that organizations would choose to use us. The loss of this potential business would be very harmful at a time when we are just coming back to life.

We believe the current law is unfair to American interests. It allows tax deductions for conventions held in Canada and Mexico. If this makes sense, then we think it also makes sense to allow the same thing for cruise ships whose flag is an extension of U.S. territory, whose owners are U.S. citizens employing other U.S. citizens, paying U.S. corporate and personal taxes.

H.R. 3191 would do just that. If it makes sense to allow tax deductions for conventions held on land, then we believe it makes sense to extend this concept to U.S ships calling at American ports. In addition, we believe the passage of this bill will not have any negative impact on the federal treasury.

Also, passage of the measure would further stimulate the successful and continued operation of two vessels presently operating on the inland waterways, the Delta Queen and the Mississippi Queen. These ships represent another several hundred jobs. Finally, this bill would create an added incentive for acquiring more vessels for both deep sea and inland waterway cruise trades.

The successful revival of the U.S.-flag passenger vessel service will stimulate the overall American economy and will contribute to national security in time of emergency or crisis. U.S.-flag passenger vessels in domestic trades will provide support to this nation's commercial shipyard mobilization base. It would put hundreds of people to work at a time when jobs are desperately needed. It would increase the maritime manpower reserve that would be needed in event of a war or national emergency.

Accordingly, we respectfully urge your favorable action on H.R. 3191.

Thank you.

Chairman **Stark**. Thank you very much for your testimony. Mr. Peter J. Luciano is executive director of the Transportation Institute. We have your statement. It will be made part of the record and you may proceed in any way you see fit.

STATEMENT OF PETER J. LUCIANO, EXECUTIVE DIRECTOR, TRANSPORTATION INSTITUTE

Mr. **Luciano**. Thank you very much. Mr. Chairman and members of the subcommittee, my name is Peter Luciano and I am executive director of the Transportation Institute.

The institute is a research and educational organization dedicated to the promotion of the U.S.-flag merchant marine. Our 174 member companies operate U.S.-flag vessels in the Nation's foreign and domestic shipping trades. Among our member companies are several which currently operate or are interested in operating U.S.-flag passenger vessels.

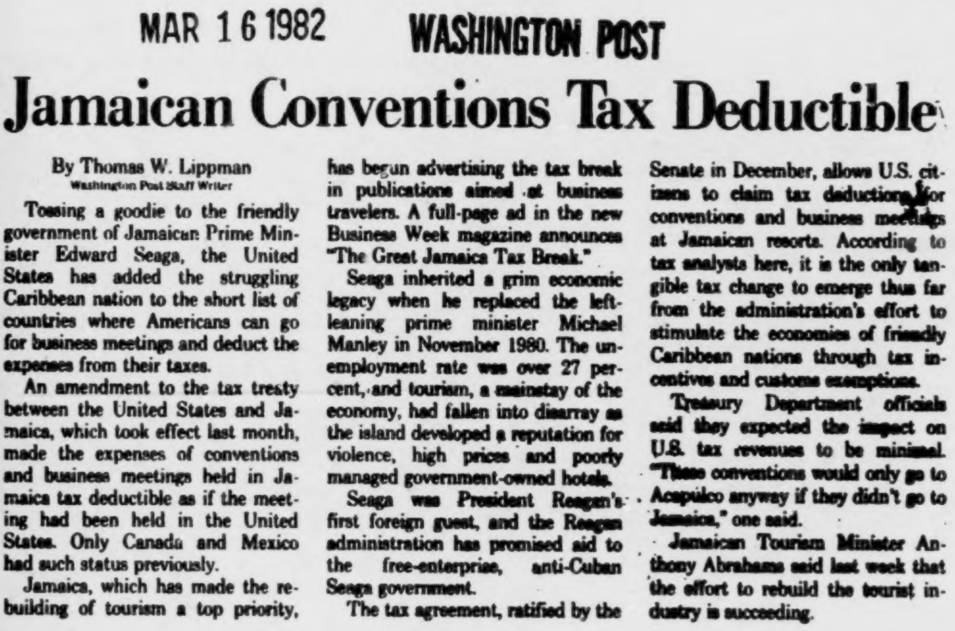
I would like to summarize my statement very briefly with a number of comments, some of which have already been made this morning by Mr. Guarini and other members of the committee. I think that our position is very simple and straightforward. All we are asking for is fairness and consistency in the application of the tax laws.

As has been pointed out, Canada, Mexico and, most recently, Jamaica enjoy the kind of tax treatment and encouragement and economic stimulation that our own American companies do not enjoy in this country. I would ask permission that a copy of the article that appeared in this morning's Washington Post on the Jamaica conventions might be entered into the record.

Chairman **Stark**. I would be pleased, without objection, to make it part of your statement and make it part of the record.

Mr. **Luciano**. Thank you very much.

[The article referred to follows:]



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Jamaican Conventions Tax Deductible

By Thomas W. Lippman
Washington Post Staff Writer

Tossing a goodie to the friendly government of Jamaican Prime Minister Edward Seaga, the United States has added the struggling Caribbean nation to the short list of countries where Americans can go for business meetings and deduct the expenses from their taxes.

An amendment to the tax treaty between the United States and Jamaica, which took effect last month, made the expenses of conventions and business meetings held in Jamaica tax deductible as if the meeting had been held in the United States. Only Canada and Mexico had such status previously.

Jamaica, which has made the rebuilding of tourism a top priority, has begun advertising the tax break in publications aimed at business travelers. A full-page ad in the new Business Week magazine announces "The Great Jamaica Tax Break."

Seaga inherited a grim economic legacy when he replaced the left-leaning prime minister Michael Manley in November 1980. The unemployment rate was over 27 percent, and tourism, a mainstay of the economy, had fallen into disarray as the island developed a reputation for violence, high prices and poorly managed government-owned hotels.

Seaga was President Reagan's first foreign guest, and the Reagan administration has promised aid to the free-enterprise, anti-Cuban Seaga government.

The tax agreement, ratified by the Senate in December, allows U.S. citizens to claim tax deductions for conventions and business meetings at Jamaican resorts. According to tax analysts here, it is the only tangible tax change to emerge thus far from the administration's effort to stimulate the economies of friendly Caribbean nations through tax incentives and customs exemptions.

Treasury Department officials said they expected the impact on U.S. tax revenues to be minimal. "These conventions would only go to Acapulco anyway if they didn't go to Jamaica," one said.

Jamaican Tourism Minister Anthony Abrahams said last week that the effort to rebuild the tourist industry is succeeding.

Mr. LUCIANO. The problem is that we are trying to rebuild the American merchant marine and particularly the American-flag passenger fleet for both economic and security reasons. This body has recently passed legislation encouraging the growth of the passenger cruise trade in the Hawaiian Islands, and that has been a very, very promising and very stimulating trade and something that has built up the fleet and provided defense resources at the same time that it has provided economic benefits.

To tie the hand of the American-flag operator simply because he is an American company, while at the same time encouraging people to go to Jamaica for conventions, is very simply unfair.

I was frankly startled by the Treasury Department's testimony this morning in opposition to this bill. It seems to me that for all the concern that the administration has for free trade and free markets for the Treasury Department to artificially cut out a piece of this market for convention business in the United States is arbitrary and capricious.

To do so is to eliminate an important market sector from the competition. It is possible that conventions held aboard ship might even be cheaper than those held at some hotels or in some foreign resorts and, to artificially cut out a part of the competitive market in that way seems to me inconsistent with the administration's policy toward free trade.

There are other inconsistencies. An American-flag passenger vessel operating on the Ohio River a few yards away from an American hotel which is allowed tax deductions for convention expenses without being allowed the same treatment, again seems arbitrary and unfair.

I think another aspect of the current tax treatment that is relevant here is the fact it implies that the U.S. maritime industry as an alien and foreign enterprise. In this regard I believe that this treatment is consistent with the way in which we have treated many other maritime issues in this country; namely, treating this industry as if it were not an American industry but rather one that we want to export and have nothing to do with as part of a national economic policy.

For these reasons we strongly support this legislation and we hope that it will be swiftly enacted. Thank you very much.

[The prepared statement follows:]

STATEMENT OF PETER J. LUCIANO, EXECUTIVE DIRECTOR, TRANSPORTATION INSTITUTE

Mr. Chairman and members of the Subcommittee, my name is Peter Luciano. I am Executive Director of the Transportation Institute. The Transportation Institute is a research and educational organization dedicated to the promotion of the U.S.-flag merchant marine. Our 174 member companies operate U.S.-flag vessels in the nation's foreign and domestic shipping trades. Among our member companies are several which currently operate or are interested in operating U.S.-flag passenger vessels.

We appreciate this opportunity to address the needs of our nation's passenger ship fleet and, specifically, to discuss H.R. 3191. As you are aware, H.R. 3191 would permit a tax deduction for convention expenses held on U.S.-flag cruise ships when all ports of call are within the North American area. We strongly believe that this bill should be enacted simply as a question of equity.

Under current law, tax deductions are permitted for convention expenses at land-based hotels. These same deductions are allowed for conventions held in Canada and Mexico. Yet the tax deduction is not permitted for a meeting or convention held onboard a U.S.-flag vessel. This puts our nation's ship operators at an unfair disadvantage in the acute competition for convention business.

The future of the U.S.-flag passenger fleet will depend to a great extent on its ability to attract a portion of the lucrative convention business. An equitable competitive position is essential to success in this effort.

We realize that this is not an opportune time to be pressing for legislation which would allow for tax deductions. The high federal deficits that are being predicted for the years ahead make it essential that any tax measure be fully justified. We are confident that H.R. 3191 meets this test upon close examination.

Although H.R. 3191 would permit tax deductions, it is doubtful that there would actually be a loss of revenue for the federal treasury if it were enacted. Much of the convention business that might be attracted to U.S.-flag cruise ships if a tax deduction existed would likely take their business to land-based hotels otherwise. Thus, most of the tax deductions would be claimed regardless of whether H.R. 3191 is enacted.

Furthermore, if H.R. 3191 is passed and the U.S.-flag passenger fleet is able to continue its recovery as a result, it could only be a boon to the federal treasury. The improved health of a vital sector of the U.S. merchant marine and the increased level of employment that would result would more than offset any possible loss of federal dollars because of the tax deduction. A revitalized passenger fleet would also improve our defense posture since the vessels would be available to perform sealift functions during time of national emergency.

During the past few years, there has been a slow but steady improvement in the condition of the U.S.-flag passenger fleet. Just a month ago, this Congress passed a bill which will allow the SS Constitution to join its sistership, the Oceanic Independence, in operating a weekly cruise service among the Hawaiian Islands. The success of these vessels will be of the utmost importance since others are watching closely to see if the U.S. flag can once again be competitive in the cruise industry. Passage of H.R. 3191 would provide a critical boost to these vessels as well as others, such as the Mississippi Queen and the Delta Queen operating on our nation's inland waterways.

I respectfully urge the Committee to give favorable consideration to this legislation.

Thank you very much.

Chairman STARK. Thank you very much for your testimony. Mr. Conrad H. C. Everhard. We have your statement, Mr. Everhard, and without objection it will appear in its entirety in the record and you may proceed.

STATEMENT OF CONRAD H. C. EVERHARD, CHAIRMAN, AMERICAN GLOBE LINE, INC.

Mr. EVERHARD. Thank you, Mr. Chairman. I appreciate having this opportunity to testify today on H.R. 3191, a bill to amend the Internal Revenue Code with respect to the tax treatment of expenses incurred in attending conventions on American-flag passenger vessels, and to urge the passage of this important legislation.

Many Americans witness the demise of the U.S. passenger shipping industry. It gradually slipped away, dying quietly as a result of high operating costs, excessive reliance on operating subsidies, and a growing impulse on the part of the public to travel by air when that mode of travel was new and fashionable. And if there were no American-flag ships with American crews there would always be a foreign ship with lower wages to fill the gap.

Paradoxically, the effective end of the American-flag passenger industry coincided with a renewed public appetite for sea travel. Popular television shows, more leisure time all combined to revitalize a popular interest in ocean excursions. Indeed, you need only examine the travel section of any Sunday paper to find literally dozens of cruises advertised, and a casual check with any travel agent will quickly determine that most of the lines or practically all of the lines are foreign flag.

If we consider Europe, also the Soviet Union, which has one of the largest passenger fleets in the world, that should probably come as no surprise inasmuch as the Soviets and most authorities readily recognize that passenger ships are easily converted to troop or hospital ships in wartime. They are ready at the blow of a whistle.

At any rate, one did not have to go far to find someone to advise you that it was foolhardy and risky to invest in any American-flag cruise venture—at least until 2 or 3 years ago, when our company decided to defy the odds, and that was, Mr. Chairman, by the way, before the tax law changed in December 1980.

We in American Globe Lines, an American corporation, were pleased to restore the *Oceanic Independence* to service among the Hawaiian Islands. Originally constructed in the United States in 1951, the *Independence* had been sold to foreign owners, so congressional action was required to reflag the ship under U.S. control, thereby making it eligible for traffic in the so-called coastwise trades.

Those routes are between contiguous or noncontiguous points in the United States. Today the *Independence* carries a total passenger complement of 750 serviced by a crew of 325.

Favorable House and Senate action in the 96th Congress with regard to the *Independence* has recently been matched in this session of the 97th Congress with regard to a sister vessel, the *Constitution*. It was only 2 weeks ago that President Reagan signed into law a measure to repatriate the *Constitution*, also intended for operation among the Hawaiian Islands.

We have taken a gamble, Mr. Chairman, but a gamble we are proud of.

With two crews on duty at any given time and backup personnel on rotation we will create some 900 seagoing jobs. Let me put it in perspective, Mr. Chairman. That is roughly equivalent to the crew level of the total of more than 35 U.S. tankers. Moreover, we are not shipping our profits overseas or taking our tourists to foreign points. Our money, our passengers, their money, and our sales tax revenues all remain in the United States. Also, our ship repair. As recently as 4 months ago, our ship was repaired in Alameda and we spent more than $1 million in that American shipyard.

Finally, we have not received any Government subsidy—and we made that decision long before the current administration's decision to effectively end subsidy under the Merchant Marine Act of 1936.

The initial capital outlay has been high and I must tell you that future prospects are largely unpredictable. Unfortunately, the tax policy of the United States has complicated matters and heightened the uncertainty.

Section 274(h) of the Internal Revenue Code, as added by Public Law 96-608, explicitly provides that no deduction shall be allowed under either sections 162 or 212 for expenses allocable to a convention, seminar, or other meetings held on a cruise ship. While this provision was originally enacted to deal with foreign conventions, neither the statutory language nor the legislative history differentiate between U.S. and foreign vessels.

As you would imagine, the language of section 274 has established a significant disincentive to travel on American-flag passenger ships. Our ships offer modern, well-equipped conference facilities. It is difficult, if not impossible, for the attendees to evade their commitment within the closed environment of a vessel. It is an ideal place for a convention.

Moreover, our successful operation creates major new employment, increases and enhances the tourist potential of the Hawaiian Islands, generates sales tax revenues, and provides the U.S. Navy with auxiliary vessels for hospital ship conversion or troop carriers on virtually a day's notice. And this at a time when the administration is contemplating the building or other acquisitions of similar crafts for the Rapid Deployment Force.

In short, Mr. Chairman, there is nothing frivolous about the potential benefits to the United States from the operation of these vesssels.

The legislation before the committee would remove the disincentive to travel on American vessels and its passage would occur at a time when our bold experiment is at a decisive point. We have been pleased by the progressive reasonableness of the Seafarers International Union, and MEBA, too, who man our ships. Labor has shown us that they share our concern for the bottom line and the leadership of my neighbor Frank Drozak of the SIU, in particular, has been outstanding.

But understanding and flexibility alone will be insufficient. We cannot resurrect American passenger shipping in the face of a tax code which offsets or outweighs other incentives.

American Global Line is proud of the risk it has taken and of the cooperation it has had from labor. We think we can continue and succeed. But we believe strongly that success can only follow the enactment of the bill before the committee today, introduced by Mr. Guarini of New Jersey and supported by Mr. Heftel of Hawaii, among others.

We urge the committee to adopt this bill so that we can have a tax code that promotes American employment in these most difficult times. Thank you, Mr. Chairman.

Chairman STARK. Thank you very much, Mr. Everhard. Our next witness is Mr. Stanley S. Thune, chairman and chief executive officer of the Delta Queen Steamboat Co.

Mr. Thune, without objection, your complete statement will appear in the record. Please summarize or provide additional information as you see fit.

STATEMENT OF STANLEY S. THUNE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, DELTA QUEEN STEAMBOAT CO., CINCINNATI, OHIO

Mr. THUNE. Thank you, Chairman Stark and members of the committee. As you have indicated, I am Stanley Thune, president of the Delta Queen Steamboat Co., which are the owners and operators of the *Mississippi Queen* and the *Delta Queen*.

BACKGROUND INFORMATION

In considering my request for your support of H.R. 3191, it might be helpful if you had a better understanding of our company, its business, and the contribution we make to the economy and the impact of this legislation.

By way of background, the Delta Queen Steamboat Co., founded almost 100 years ago, operates two overnight steamboats, the 400-passenger *Mississippi Queen* and the 200-passenger *Delta Queen*. Both vessels carry only passengers who travel from New Orleans to Minneapolis-St. Paul on the Mississippi River and from Cairo, Ill., to Pittsburgh, Pa., on the Ohio River.

Our inclusion in the current law, Public Law 96-608, could threaten *Delta Queen's* viability and certainly limits its growth. Our company has lost money every year since 1976, when the *Mississippi Queen* was commissioned. However, in the last fiscal year, the company, which recently became public and now has over 12,000 shareholders, has been able to achieve a profit.

ECONOMIC CONTRIBUTION AND IMPORTANCE

The Delta Queen Steamboat Co. is owned and operated by American citizens. It makes an important contribution to the overall U.S. economy, since we employ over 400 people, 300 of which are union employees belonging to MEBA and the SIU, the Seafarers International Union.

Our steamboats carry passengers who purchase goods and services over a 14-State area. The company purchases daily supplies and fuel for both vessels from local merchants. In addition, we maintain our vessels in U.S. shipyards. Last but not least, now that we are profitable, we pay taxes in the United States.

There had been some discussion about the offset of the loss of tax revenue and such. Just a cursory view would indicate to us that the potential tax loss revenue would be more than offset by any increases in profitability and increases in employment and employment taxes that would be paid.

MARAD GUARANTEE

In a sense, the U.S. Government, through the Maritime Administration, has a large stake in our company's success. Since MarAd has guaranteed the bonds under which *Mississippi* was constructed during the mid-1970's. At the present time this guarantee amounts to a little less than $14 million. The initial debt was $19 million. So we have paid back $5 million.

It is possible that the limitations of Public Law 96-608 could at some time undermine our ability to continue to meet these bond repayment obligations, especially in the current economic environment, where companies as ourselves are looking for new market segments and new areas to participate. This further supports the reasonableness of our request.

RECOMMENDATION

The company is presently embarking upon a program to attract more people to its vessels and consequently further develop our business in the United States. The passage of H.R. 3191 would help us grow and develop as a company and perhaps even build a third vessel, although I must be quite honest that is a couple of years away.

However, we are in the process of seeking approval to increase our capacity by about 10 percent by adding rooms to the *Mississippi Queen* in 1983 which would again increase job potential on the vessel.

By way of summary, I would respectfully ask you to support H.R. 3191, which would allow organizations holding conventions and seminars aboard American-flag vessels in the North American area tax deductions which they can now obtain by holding these same meetings in Canada, Mexico, and, most recently, in Jamaica.

Thank you for your time and interest, Mr. Chairman.

Chairman **Stark**. Thank you very much.

I just have two very quick questions. They are for Mr. Everhard or Mr. Thune. If this bill passed, are the economics of your industry such that we might have 10 or 15 new either oceangoing vessels or riverboats suddenly being created?

Mr. **Everhard**. Mr. Chairman, it is like anything else in life. Success begets success. Like I said before, here we have a bunch of fine athletes at the table, and I think of Roger Banister, nobody could humanly break the 4-minute mile. That is what was said. But the day he did it, within 4 weeks after that, there were five guys who did it. So it is as simple as all that.

My answer to that is yes, Mr. Chairman.

Chairman **Stark**. Thank you. Now, I am also a little confused by the Treasury's position, because I think I have a solution for your problem if the bill does not pass.

We have the *Queen Mary* and the U.S.S. *United States;* if they have merely removed the propulsion equipment and tied them up some place and called them hotels they could be booked. I think one is in San Diego Harbor and I do not know where the other one is.

Now, it seems to me that if that is legal, then all you have to do is throw your engines away and tie up some place, and then you can have a convention. And that does not really make a lot of sense to me. But if I interpret it correctly, I think that is the case. Is not the *Queen Mary* operating some place in San Diego? Is it in San Diego?

Mr. **Everhard**. Long Beach.

Chairman **Stark**. Long Beach. All right. And it is a hotel.

Mr. **Everhard**. Yes, yes.

Chairman **Stark**. But it floats.

Mr. **Everhard**. Right. That is why the statement this morning by the Secretary was not only disappointing, but there was a tremendous incongruity there. The salient point really is what is a convention. We are not trying to change the law or the statutes, but the parameters, of holding a convention. All we want to make sure is to have it on a vessel, too. And the costs to the Revenue Service, I understand from your staff, and which I read in the little booklet, is negligible.

So basically, it is for a layman like myself, that testimony is almost beyond my mental ceiling.

Chairman **Stark**. Thank you.

Mr. Guarini.

Mr. **Guarini**. Thank you, Mr. Chairman.

Just as an observation on the wisdom and logic of our tax policies today, you could go on any foreign or domestic airline to Jamaica and take a business deduction, but if you take an American ship manned by American workers, you cannot take a deduction.

It just boggles my mind to think that the Treasury Department should put itself in that kind of a box.

Interestingly enough, the very tax policy of this country undermines the maritime industry. Our shipyards are empty. We went down from 5,000 U.S.-flag ships to 500-some-odd U.S.-flag ships. We give tax advantages to companies that build and repair ships in foreign shipyards that we do not do for our own shipyards. We even encourage the demise of our shipping industry.

Now, Mr. Drozak said that perhaps what we should do is take the Department of the Treasury out on a cruise. I think if they did something like that, someone is going to pull the plug on them, because they certainly have not been acting in the best interests of our national defense or our national economy.

And I think that these observations are so self-evident that they should not even have to be made.

I know that the jobs are important. I know that on the Hudson River at one time there were many cruise ships. Now I see very few, if any, cruise ships. And whatever I do see seems to be a foreign cruise ship taking American money and banking it elsewhere.

The concept of taking a dead ship, taking the motor out of it, does not really help us at all when we are talking about national defense. I sat in this room and had a private briefing by the armed services as to what Russia is doing today with its maritime fleet. They have one of the finest maritime fleets in the world today, because it is an arm of their national defense policy.

On one hand we are spending hundreds of billions of dollars trying to build up our defense posture. On the other hand we are denying an industry which is critical and essential to our national defense position.

So the logic of everything that is being done by the administration just escapes me, and I do not think it is defensible at all.

I would like to make a statement and say that it is clear to me that if we built an industry up, the Government and the taxes that they would get in return would be making money, that this bill would not cost the Government any money, with the return on the jobs that you would get from the workers and the painters and the financial institutions doing the financing and the beverage and the food industries and everything else that goes into a ship.

And all the taxes that are being paid by the workers on the ship and everything that is being done in the steelyards and all the fittings that are being done in the shipyards are all moneys that are going to be returned to the U.S. Government because what you will do, in essence, is build up an industry which we need for our economy. So we are taking jobs away in a labor-intensive industry when we should be looking for, as one of our first national priorities, of giving jobs to our people.

I really do not have any questions that I want to ask, because the whole thing is so self-evident that you have to almost be anti-American to vote against the bill.

Chairman **Stark**. Thank you, Mr. Guarini.

Mr. Duncan.

Mr. **Duncan**. I have no questions. I want to thank the panel, and I want to assure you of my support for your initiatives. Thank you.

Chairman **Stark**. Thank you.

Gentlemen, thank you very much. I hope that the committee is able to find a solution to your problem. We appreciate your taking the time to come and testify before us today.

I would like at this time to ask the distinguished chairman of the Subcommittee on Social Security, a member of the Ways and Means Committee, a Member of the House of Representatives, Mr. J. J. Pickle from Texas, who is here to testify on behalf of his bill, H.R. 5630, to introduce the other members of the panel who will testify on behalf of this bill, and to state that if California had such tough representation on the Ways and Means Committee, their judicial system and their judges would be in tall clover.

Mr. Chairman, you are to be congratulated for your advocacy. And you may proceed in any manner that you see fit.

STATEMENT OF HON. J. J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. **Pickle**. Mr. Chairman, I thank you very much.

At the risk of not fully understanding what you said, I am going to accept it because I think it was generally favorable. And I thank you for your comments.

I am privileged that you have given me the courtesy of introducing the two panelists who will speak to you with reference to the bill H.R. 5630.

The first to testify will be Mr. Joseph Cain, who is can attorney in Austin, Tex. He represents the Texas State Bar Association Committee on Selection, Tenure, and Compensation of Judges.

The second person to testify will be Hon. Joe R. Greenhill, who is chief justice of the Texas Supreme Court. Judge Greenhill and I are kind of related by family ties. We were classmates at the University of Texas. I must say to you that I have the highest respect for him. But this respect is shared by everyone in Texas. He is one of the State's and Nation's outstanding jurists. I know you will be anxious to hear his testimony.

Mr. Chairman, rather than make a statement to you now, I have a prepared statement, which I have submitted to the committee. With it I have an appendix A, which will illustrate the impact section 457 would have on the Texas district and appellate judges. I invite the panel's attention to that last sheet.

Let me just say by way of a very brief statements that I was a member in 1978 of the Committee on Ways and Means when we passed the deferred compensation legislation. It dealt with optional salary reduction arrangements sponsored by local and State governments.

It was not intended to address the regular mandatory retirement plan maintained by the State or local governments.

Now, by virtue of an oversight, we find the Internal Revenue saying, in effect, that section 457(e)(1) would be applicable to Texas judges. This is a harsh development and would mean, that unless some changes are made, a judge in our State, when he became vested, would be subject to an enormous income tax liability. And it would not be a question of liability on retirement benefits received, to which we have no objection, but rather liability due when a judge vests, even though no benefits had actually been received.

You can see on the last sheet the example I gave you of a judge who vested at 65. You could see that he could be subject to an income tax on somewhere in the nature of $233,000.

Well, that was not intended by Congress. I am glad this morning that a representative of the Department of the Treasury testified in support of this legislation.

So, if it would be permissible, Mr. Chairman, I would like to refer first to Mr. Cain to submit testimony for the State bar.

Chairman **Stark**. Thank you very much, Mr. Pickle.

Without objection, your prepared statement and the appendix which I know you were kind enough to submit at my request so that I could understand in numerical terms the problems faced by the members of the bar or by the judges in your State. And it does just that. I am glad, as I said earlier, to find that the Treasury has agreed to find a solution for this.

[The prepared statement follows:]

STATEMENT OF HON. J. J. PICKLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Thank you, Mr. Chairman, for this opportunity to explore the applicability of Section 457 of the Internal Revenue Code to certain State judicial retirement plans.

Section 457 was enacted by Congress in 1978 in response to questions raised by proposed Treasury regulations which dealt with non-qualified salary reduction deferred compensation arrangements. Section 457 was adopted to clarify the taxation of benefits under optional salary reduction arrangements sponsored by State and local governments. The legislative history of Section 457 supports my views that the provision was not meant to address the regular mandatory retirement plans maintained by the State and local governments.

Congress wrote Section 457 into the Code to accomplish two things: (a) to establish structural requirements which deferred compensation salary reduction plans would have to meet to earn favorable taxation; and (b) in Section 457(e) to specify the tax treatment of salary-reduction plan benefits which failed to meet the structural requirements.

Under Internal Revenue Service regulations that become final beginning in 1982, if a plan fails to satisfy the requirements of an eligible State deferred compensation plan, Section 457(e)(1) provides that compensation deferred under such a plan is currently includible in a participant's income for the first taxable year in which there is no substantial risk of forfeiture -- that is, upon vesting. However, Congress provided an exception from this treatment for certain plans such as qualified Section 401(a) plans, tax-deferred annuity plans, etc. The Service recognized at the time it promulgated the proposed Section 457 regulations that there are State plans that are the regular retirement plan of the State but which do not qualify as an eligible State deferred compensation plan under the 457(b) structural requirements and which do not come within any of the exceptions to Section 457(e)(1). Thus, participants in these plans would appear to be subject to the severe tax treatment requiring the inclusion of all such deferred compensation income in taxable income immediately upon vesting.

This is a very harsh result and in some cases is one which probably goes well beyond what Congress was attempting to get at by the adoption of Section 457. In fact, in the preamble to the proposed regulations the Internal Revenue Service acknowledges that it is unclear whether this result was intended. The reforms brought about by Section 457 were an attempt to prevent situations where employees of State and local governments could defer recognition of income through optional deferred compensation agreements with their employers.

The problem with the 1978 provision came to my attention when the regular, mandatory retirement plan of the Texas state judges appeared not to be excluded from the Section 457(e)(1) penalties. It is my understanding that this state judges plan was just the type of plan that the Internal Revenue Service acknowleged was an unintended victim of the broad language of present law Section 457.

Because I believe the application of Section 457(e)(1) penalties was not intended to cover state judicial plans that are the regular, mandatory plans for service as a judge, I have introduced H.R. 5630 to correct this situation. I perceive this legislation to be technical in nature because I believe Congress would have taken care of this problem in 1978 had it focused squarely on the issue.

My bill would add to the exceptions from Section 457(e)(1), state judicial plans that are the regular, mandatory plans for service as a judge.

H.R. 5630 is in no way aimed at weakening or circumventing the reform that was brought about by Section 457. It contains no loopholes for the kind of optional deferred compensation arrangements limited by the 1978 act. This exception, for certain state judicial plans is very narrowly drawn and provides that the judicial plans must be regular, mandatory retirement plans for service as a judge. The bill does not allow additional, optional contributions by judges that would affect includible compensation, thus helping to carry out the original intent of Section 457. To ensure that the bill does not carve out safe harbors for newly adopted plans, my bill contains a limitation clause providing that judicial plans to be excepted must have been continuously in existence since December 31, 1978, the point after which Section 457 becomes effective. The provisions of the bill are effective with respect to taxable years beginning after December 31, 1978.

I believe this legislation is consistent with our action in 1978, and I believe it is a fair treatment of an unintended problem. Finally, I would conclude by saying that without this legislation, I believe irreparable harm will be inflicted on the judiciary of certain states. This is far beyond what Congress intended when it enacted guidelines and requirements for optional deferred compensation agreements made between state and local governments and their employees.

Thank you, Mr. Chairman.

APPENDIX A

Illustration of Impact of §457(e) on Texas District Judge

Assume:

1. District Judge is paid $44,668.00 per year.
2. Of this, he is required to contribute 6%, or $2,680.08, to the plan.
3. He becomes vested in his retirement benefit after 12 years of service.
4. His retirement benefit is a straight-life annuity, commencing at age 65, equal to $26,800.80 per year, which is 60% of his compensation.
5. In applying §457(e), a 6% interest assumption is used.

What amount is includable by him as taxable income on the day he vests?

A. If he is 35 years old when he vests, he includes:

Present Value of Annuity	44,136.27
Less Sum of His Contribution	32,160.96
Includable Income	11,975.31

B. If he is 50 years old when he vests, he includes:

Present Value of Annuity	107,830.30
Less Sum of His Contribution	32,160.96
Includable Income	75,669.34

C. If he is 65 years old when he vests, he includes:

Present Value of Annuity	265,812.02
Less Sum of His Contribution	32,160.96
Includable Income	233,651.06

Chairman **Stark**. We are also happy to welcome Mr. Joseph Cain to the committee. We will make your complete statement a part of the record. And you may proceed in any manner you see fit.

STATEMENT OF C. JOSEPH CAIN, MEMBER, COMMITTEE ON SELECTION, TENURE AND COMPENSATION OF JUDGES, TEXAS STATE BAR ASSOCIATION

Mr. **Cain**. Thank you, Mr. Chairman.

I would like to begin by recounting the history of our efforts——

Chairman **Stark**. Mr. Cain, if I might interrupt, you would make life easier for all of us if you spoke louder.

Mr. **Cain**. Certainly. I would like to begin by recounting the history of our involvement with 457, very briefly, if I may. When the Internal Revenue Service proposed its regulations under 457, they expressed in their introductory comments to those regulations a concern that the statute as it was written in 1978 could be interpreted to reach mandatory regular retirement plans and to impose upon those plans a tax on vesting rule.

The Internal Revenue Service was sensitive to the legislative history behind 457, and believed, as we always had, that section 457 was intended to govern the design only of optional salary reduction agreements.

We went to the hearings on the proposed regulations and urged this position with the Internal Revenue Service and the Department of the Treasury. And while they were and continue to be sympathetic with our feelings about the legislative history, they believe that they were simply not in a position as an administrative body to do what the statute did not clearly do in its own language.

For that reason, we turned to the Congress and are in support of H.R. 5630 at this time. That bill does add to section 457 language which would exempt from the tax on vesting rule of 457 the regular mandatory retirement system that operates for the benefit of State judges. And that seems to us to be quite consistent with the original intent of 457. And I think Treasury in its testimony this morning very clearly agreed with that.

I would like to stress to the subcommittee that we are not asking for an exemption from taxation on our pensions. We are asking simply to be restored to the tax pattern which we all knew was the case prior to 1978. And that is that when a member of a qualified State judicial plan receives his benefits, he will pay full tax at the ordinary rate on those receipts.

So this is not a situation in which this legislation would extend to members of a qualified State judicial plan tax advantages which are at this point reserved for participants in any sort of tax-qualified plan.

We believe not only that it is consistent with legislative intent to enact H.R. 5630, but it also, it seems to us, very consistent with very broad tax policy. The general rule is that an individual taxpayer pays tax on the cash basis. He is taxed when the promise of compensation is performed rather than when it is made. And the tax on vesting rule is a quite different matter. Under that rule a taxpayer is required to pay tax when the promise is made and the conditions precedent to the promise are satisfied.

So that the imposition of 457(e) as it is presently written on mandatory regular retirement systems is quite a wide departure from very basic tax policy of individual taxation. And while it is consistent to tax a promise at the time it is made when the taxpayer is involved in the negotiation of that promise and when he could just as easily have taken the money as have agreed to defer it, it is not, it seems to me, consistent with tax policy to require a taxpayer to pay tax on that promise when he has no hand in its design and has no option to take the money instead of the promise.

State judicial retirement systems under this statute are mandatory. There is no option. There should be no basis for the taxation of the mere promise. And this bill would bring 457 back in line with that very fundamental tax policy. We very strongly support it.

Chairman STARK. Thank you very much, Mr. Cain.

And now we will hear from Hon. Joe R. Greenhill, chief justice of the Supreme Court of Texas.

Mr. Chief Justice, welcome to the committee. Your statement will appear in the record in its entirety. We are pleased to have you with us today. You may proceed in any manner that you prefer.

STATEMENT OF HON. JOE R. GREENHILL, CHIEF JUSTICE OF THE TEXAS SUPREME COURT

Judge GREENHILL. Thank you, Mr. Chairman. I will try to be very brief and will try to emphasize if I can the terrific practical results of the legislation if not corrected.

I began my service on the Texas Supreme Court in 1957. I will soon have been there 25 years. I have been chief justice since October of 1972. I came to the court with the Texas Retirement Act already in being, which provided that 6 percent of our pay would be deducted, no questions asked, no opportunity to say yes or no.

Wisely or not, the legislature did not provide a funding base but simply pays our retirement out of ordinary income. The plan provides for earning or vesting of the retirement benefits after 10 years on the bench. The retirement plan, as I said, vests after 10 years on the bench, which would have been 1967. So I vested in 1967.

It also provides that after 20 years on the bench you can start drawing it regardless of your age. So I have also vested again in 1977. I still did not draw retirement, and my term expires in 1985. I asked the people at the retirement board to give me an estimate of the value of the retirement benefits which I have. And I was told that it was in the vicinity of $525,000.

If I had to pay income tax on $525,000 at any one time, there is no way I could do it. I also understand that the law provides that community property laws will not be applicable, so I cannot split it in half.

So we are looking at a very substantial tax all in a very large lump sum. And even resigning my position will not escape the tax. The tax vested in 1967 was vested again in 1977 and if the law is not changed, I am dead. Instead of having a retirement benefit, I will look forward to trying to pay off the income tax consequences of 25 years of service.

I think that perhaps that illustrates the point, and I will stop right there.

Mr. DUNCAN. Thank you, Mr. Chairman.

I want to thank the panel and you gentlemen. I must say that you do have a good advocate in Mr. Pickle. I am sure you will get great support from most of the members of the panel, including this one. Thank you.

Judge GREENHILL. I may return the compliment. Mr. Pickle has been one of my closest and best friends for many years. We call him "Jarring Jake."

I thank the committee.

Mr. GUARINI [presiding]. Mr. Justice, your cause is just, and I should think you would have no trouble at all on a bill like this, because you have a champion in Mr. Pickle, who is really one of our great leaders.

Not only that, what we have done with the IRA and Keogh plan and all those others, well, you are asking no more than what we have done for the rest of our society. And your public service certainly entitles you to as much, if not more.

So I want to really thank you very much. And I assure you that you have my support and some of the people that I can muster up for you, their support as well.

Mr. PICKLE. Thank you very much.

Mr. GUARINI. Jake, is there any way you want to sum it up?

Mr. PICKLE. Mr. Chairman, I thank you very much for your courtesy. The justice does have a just cause. And we thank you for your understanding of it. I think we will rest our case at this point. Thank you very much.

Mr. GUARINI. We will take a 5-minute recess at this point and will come back at 2:25.

[Recess.]

Mr. GUARINI. We will now take up several pieces of legislation, and they are the following:

H.R. 612, to amend the Internal Revenue Code of 1954 to repeal the provisions requiring withholding of tax on certain gambling winnings;

H.R. 2647, to amend the Internal Revenue Code of 1954 to equalize the dollar amounts of income tax withholding on gambling winnings from horseracing, State-conducted lotteries, and other wagers;

H.R. 2981, to repeal section 3402(q) of the Internal Revenue Code of 1954, which requires for income tax purposes, amounts to be withheld from certain gambling winnings; and

H.R. 4592, to amend the Internal Revenue Code of 1954 to eliminate the withholding requirements with respect to gambling winnings, to provide that information returns with respect to winnings over the sum of $10,000 or more, or to allow a 3-year carry-over in net gambling losses.

We are very honored to have Senator Howard W. Cannon. I ask him if he will make his presentation.

Senator, we welcome you.

STATEMENT OF HON. HOWARD W. CANNON, A U.S. SENATOR FROM THE STATE OF NEVADA

Senator CANNON. Thank you very much, Mr. Chairman and members of the subcommittee. I want to thank you for the opportunity to testify today. I strongly support Mr. Holland's bill H.R. 4592. This measure would, if enacted, be a signficant reform of existing law governing the tax treatment of legal gaming activities.

Let me just say from the onset that this is not the first time that I faced a congressional committee on this issue. Throughout my Senate career, I have pioneered the reform of current gambling laws through the legislative process. Consequently, I am particularly pleased to see the House of Representatives is considering H.R. 4592.

I would like to take just a moment to review some of the efforts I have undertaken, because I think they are important to the consideration of this measure.

In 1971 I authored and secured passage of the slot machine tax credit legislation which allowed an 80 percent rebate to Nevada. And later, in 1978, I succeeded in increasing the rebate, first to 95 percent and then to 100 percent as of 1981. These moneys were earmarked by the State for educational purposes. And the credit is currently bringing in more than $25 million per year.

Now, over a 3-year period beginning in 1974 I served on the Commission on the Review of the National Policy Toward Gambling, which collected, reviewed, and summarized all available material on gambling. Every aspect of gambling was researched and surveyed.

I attended most of the 43 hearings which were held in various locations throughout the country, including my own State of Nevada. Testimony from over 275 Federal and State officials as well as ordinary citizens was heard by the Commission.

I believe the Commission's findings and recommendations are particularly significant in light of the legislation that the committee is reviewing today. For example, the Commission found that the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders.

Furthermore, the Commission recommended that the Federal Government, in the exercise of its regulatory and tax powers, should take care not to hinder State efforts to compete with illegal gambling.

The Commission also discovered a most startling fact: The United States is the only country in the civilized world to impose an income tax on gambling winnings. Every other country tax gaming operations but not those patrons who are encouraged to support it. Each country rejected an income tax on gambling winnings because of its negative impact on legal gambling operations in direct competition with illegal gambling operations.

The Commission also concluded that current tax policy on gambling winnings contributes to the success of gambling operations run by illegal operators.

Furthermore, the overriding concern of the Commission in the area of Federal taxation of gambling winnings was the prevention of Federal interference in the domain of State production of revenue.

On the subject of withholding, the primary focus of Mr. Holland's bill, the Commission seriously questioned whether withholding serves to further any identifiable national interest.

Furthermore, the Commission condemned withholding from gambling winnings, concluding that such withholding—and I quote from the Commission's final report:

> Will increase the advantage of illegal operators, generate minimal revenues to the government, and unnecessarily increase the administrative burden to the legal gambling business. The Commission recommends that Congress reexamine the probable impact of section 1207 of the Tax Reform Act of 1976. If upon reexamination Congress finds the proposed withholding tax to be destructive of existing legal gambling industries, the Commission recommends that these withholding provisions be repealed.

Another recommendation of the Commission involved a 10-percent excise tax on legal wagers and the $50 occupational tax on employees of legal wagering facilities. The Commission recommended that these taxes be repealed.

In 1974 I was successful in securing Senate passage of a bill to repeal these taxes. But subsequent conference action reduced the excise tax to 2 percent and established the occupational tax at $500.

At the end of the last session I introduced an amendment to the Miscellaneous Tax Act of 1981, a bill which is currently pending in the full Ways and Means Committee. This amendment further reduces the excise tax to one-quarter of 1 percent and reduces the occupational tax to $50.

I think each of the Commission's findings and recommendations have merit and are certainly relevant to the consideration of H.R. 4592.

And finally, Mr. Chairman, I have introduced legislation in the Senate, S. 1861, which is almost identical to Mr. Holland's bill. I have done so because I believe that withholding is counterproductive, stimulates illegal gambling, and reduces essential State revenues.

I think this is particularly important with the current emphasis on the States assuming a greater responsibility for providing services to its citizens. Instead of impeding the State's ability to raise revenue, the Federal Government should be facilitating these efforts in every way possible.

Now, Mr. Chairman, as I have repeatedly stated, I have and will continue to support those policies which have proven to be effective in the deterrence of illegal gambling. I think we must do everything we can to insure that illegal operators are halted in their tax-free ride at the expense of those law-abiding taxpayers.

However, Mr. Chairman, when a policy proves to be ineffective, and once more even harmful to those States responsible for its compliance, to the benefit of its illegal counterpart, then I must question its validity.

And while no withholding currently exists for legal casino payouts, I must say that I am gravely concerned about the adverse effects of withholding from legal payouts in 30 other States.

The second provision of Mr. Holland's bill and the bill I introduced with my colleague, Senator Laxalt, increases the reporting level for payout to $10,000. I think this is a realistic figure and would insure reporting of nearly all wagering transactions involving real tax liability.

In aggravated form, the adverse effects of withholding on legal gambling in other States resemble the adverse effects of existing Federal tax policy in Nevada. In particular, the reporting requirements have been unnecessarily burdensome and have seriously damaged Nevada gaming.

The last provision of H.R. 4592 and S. 1861 provides for a 3-year carryforward or carryback on gambling losses. Certainly, I think it is important to remember that the Federal Commission found that almost all players sustain net losses over their gambling careers. Current policy, which does not permit a player to receive credit for losses that exceed current-year payouts appears impractical and unfair and unnecessarily encourages players to patronize illegal gaming operations.

Gaming transactions should be treated as other capital transactions. I believe a degree of equity is sorely needed in this area. And this provision would achieve that goal.

In conclusion, Mr. Chairman, most of the current Federal laws relating to gambling were enacted with good intentions. However, experience has shown that these policies do not live up to their justifications; that is, increased revenue and the inhibition of illegal gaming operations. Indeed, these provisions have realized little revenue and have actually encouraged illegal gambling.

Once more, current Federal tax policy results in an unfair and discriminatory treatment of legal gaming patrons by taxing legal payouts. This unfair treatment has discouraged legal play and has stimulated illegal gambling. As such, Nevada's revenues are reduced by an estimated $3.5 million and serves only to harm my State's multimillion-dollar legal gambling industry.

I believe it is critical for the Federal Government to take heed of the Federal Gambling Commission's recommendations and leave gambling policy up to the individual States where it rightly belongs.

I strongly support Mr. Holland's bill, and I urge the subcommittee's favorable consideration. Thank you .very much, Mr. Chairman. If you have any questions, I would be very happy to respond to them.

Chairman STARK. Senator, thank you very much. I apologize for not being here at the beginning of your testimony. But I appreciate your taking the time to come here and represent Nevada's interests so well. Thank you.

Mr. Guarini.

Mr. GUARINI. Do I understand, Senator—and I thank you for your testimony—that only the U.S. taxes winnings?

Senator CANNON. That is the result of our study. The United States is the only country that taxes in an income tax form gambling winnings.

Mr. GUARINI. And in some of those foreign countries there are lotteries on soccer and football that probably are even greater in numerical dollars, or whatever their exchange is, than what we have here?

Senator CANNON. Well, of course, we have seen the sweepstakes and lotteries that they have in many instances. Of course, many of them have the regular traditional gambling establishments such as we have as well in the State of Nevada.

Mr. GUARINI. From what you say, you would go beyond this bill, not to limit it to $10,000 but that you would prefer to have no withholding at all. Is that correct?

Senator CANNON. Well, I would prefer no withholding or no reporting at all. But we have recommended in the bill that I introduced, we put the upper limit of $10,000 on for reporting purposes. Now, I certainly would oppose withholding, although some States now have withholding on a portion of when the odds are over a certain figure they have withholding that is required.

Mr. GUARINI. Do you see any philosophical difference in the gambling when you talk about a 3-year carryover that people do at a racetrack or a jai alai or a lottery as opposed to betting on the stock market or the commodities exchange where they put down a small amount and bet on indexes and all types of different kinds of things that fluctuate from moment to moment?

Senator CANNON. I think they are quite comparable. Of course, we know the stock market is the biggest gamble around.

Mr. GUARINI. Even more than a horse race?

Senator CANNON. In this day and age, even more than a horse race.

Mr. GUARINI. I agree with that. Thank you.

Thank you, Mr. Chairman.

Mr. SCHULZE. If the gentleman would yield, I have just one question of the distinguished Senator.

Senator, in the Commission's deliberations, did they reach any conclusions as to the extent of illegal gambling in countries where there is no taxation? Is there any kind of parallel or corollary where perhaps illegal gambling activity declined? Or have they just never had taxes on this sort of thing?

Senator CANNON. Well, we did not run into the proposition of illegal gambling except here in our own country. I think that it could be certainly assumed that one of the reasons was because of the type of treatment that it had in foreign countries, and therefore there was no incentive. Here in our own country there was indeed an incentive.

For example, a few years ago, when the wagering tax was 10 percent, you simply could not make a wager on a sports event or on a race and have it operated legally because no one could afford to pay the tax. The margin is not that big. Right now the margin is very, very small. And many of the sports books now are not making a profit, simply because of the 2 percent they are having to pay now.

We think if we can get it as we have done in the Senate now, reduce it from 2 percent to a quarter of 1 percent—and I may say I was for removing it entirely, but I had to take the quarter of 1 percent as a compromise—if we put it down to that point, then it does leave them the opportunity to make a profit and furthermore will discourage the illegal bookie because he has no incentive there, nor does the player have an incentive, a real incentive to play with him, and will help discourage illegal gambling.

It helped discourage it when we dropped from 10 percent down to 2 percent, but not as much as it would by removal or going from 2 percent to a quarter percent.

Mr. Schulze. So you would say from your experience, serving on that Commission, that the tax is an incentive to illegal gambling and the removal would be a disincentive for illegal gambling?

Senator Cannon. Absolutely. A removal would sound the death knell to the illegal bookie, to the people who are taking the illegal bets, because their only reason for taking it is to avoid paying the tax that is now required to the Federal Government.

Mr. Schulze. I thank the distinguished Senator.

Mr. Guarini. Coming from New Jersey, I am just beginning to understand the problems of Nevada, Senator. Thank you very much. We appreciate your being here.

Senator Cannon. Thank you.

Mr. Guarini [presiding]. Our next witness is Congressman James Santini.

[Pause.]

Mr. Guarini. Jim, welcome.

STATEMENT OF HON. JIM SANTINI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEVADA

Mr. Santini. Thank you very much, Mr. Chairman. I appreciate the opportunity to join with my newly found ally in the House of Representatives from New Jersey and other interested members of the committee to discuss this issue of vital concern to the State of New Jersey, to the State of Nevada.

And in view of the sizable investment from the chairman's district in the State of California, I am sure that he has a passing interest in this subject matter, even if it is across the border for the interest of some of his constituents.

I want to share this appreciation with Congressman Holland. I have joined with him to cosponsor this legislation because I think it makes good sense as well as good legislation. As a representative of Nevada's legal gaming industry, the economic health and survival of my State is dependent upon this critical industry.

Our State Government receives $148 million—I realize that palls when compared to the income in New Jersey, but it is still awfully important out there in the State of Nevada—or 51 percent of its revenues from direct levies on gaming activities.

If indirect gaming-related activities are included, the total contribution to our State and local government equals 81 percent of our State's revenues.

State and local governments are not the only ones to benefit directly from the Nevada gaming activity. The Internal Revenue Service receives approximately $1.6 billion from companies and individuals engaged in gaming and tourism in the State of Nevada.

The economic health and vitality is obviously dependent upon the continued success of this business enterprise, as it is responsible for about 60 percent of the employment in our State.

As will be documented by witnesses that will be appearing before you this afternoon, unfair reporting requirements have hurt our legal gaming industry. There is evidence that people have stopped playing the legal games as a result of being subjected to the requirements of the W-2G form.

What those requirements appear simply to be doing is encouraging gamblers to seek out illegal games where no one pays any taxes to either the State or the Federal Government.

Why do gaming patrons object to reporting funds received during keno, bingo, and slot machine play? Obviously, you have the general enthusiasm about paying taxes that influences every conscientious American around April 15. Well, very simply, over the long haul, gamblers are net losers. That may come as a shock and surprise to some on the committee, but for those who question the validity of this conclusion they need only pay a brief visit to the shores of Atlantic City, the strip of Las Vegas, or the hotel complex in downtown Reno.

The result of requiring this type of reporting on these games is the players fear they will be taxed for their short-term gains and will be unable to prove their losses. Most players receive very few significant payouts and will have very little incentive to record those losses until after they win an amount that is equal to that loss.

Even if they make a conscientious effort to record losses, it is unclear exactly what kind of proof would satisfy the skeptical review of the Internal Revenue Service.

For example, is it plausible or acceptable evidence that our bingo and slot machine players would record the nickels and quarters that they spend on an abacus? What would be acceptable proof of loss?

Raising the reporting level of payouts to $10,000 would insure reporting of virtually all real taxable liabilities while eliminating the undue burden on both the legal betting establishment and the player.

Our bill H.R. 4592 would serve to provide some equity for the legal gaming patron. I urge the favorable consideration of this committee on this important legislation. I would be happy to consider any questions or comments members of the committee might wish to share.

[The prepared statement follows:]

Statement of Hon. Jim Santini, a Representative in Congress From the State of Nevada

I want to commend Congressman Holland for introducing this important legislation which is so crucial to the legal gaming industries of America. I also want to express my appreciation to Chairman Stark for scheduling these hearings so expeditiously.

As the representatives of Nevada's legal gaming industry will testify today, the health of my state's leading industry is absolutely vital to the 799,000 residents of the Silver State. Our state government receives $148 million, or 51 percent of its revenues from *direct* levies on gaming activities. If indirect gaming-related activities are included, the total contribution to state and local governments in the state equals 81 percent of revenues.

State and local governments are not the only ones to benefit directly and indirectly from Nevada gaming activities. The Internal Revenue Service receives approximately $1.6 billion from companies and individuals engaged in gaming and tourism activities in the state. The health and vitality of my state depends on the continued success of this business enterprise, as it is responsible for about 60 percent of the employment in Nevada.

As will be documented today, unfair reporting requirements have hurt our legal gaming industry. There is evidence that people have stopped playing in our legal establishments as a result of being subjected to the W_2G requirements. What those requirements appear to be doing is simply encouraging gamblers to seek out the illegal games where no one pays taxes to the state or Federal government.

Why do gaming patrons object to reporting funds received during keno, bingo and slot machine play? Very simply, over the long haul, gamblers are net losers. The result of requiring this type of reporting on these games is that players fear they will be taxed for their short-term wins and will be unable to prove their losses. Most players receive very few significant payouts and will have little incentive to record those losses until *after* they get lucky and win a reportable amount of funds. Even if they make a conscientious effort to record losses, it is unclear what type proof would be acceptable to a skeptical official of the Internal Revenue Service. Do we expect our bingo and slot machine players to record the nickels and quarters they wager on an abacus? Would that be acceptable proof of loss?

Raising the reporting level of payouts to $10,000 would ensure reporting of virtually all real tax liabilities while eliminating the undue burden on both legal betting establishments and players. HR 4592 would serve to provide some equity for the legal gaming patron. I urge this subcommittee to act favorably on this matter.

Mr. GUARINI. Jim, you sound like you have a bestseller in this title of "Gamblers Are Net Losers." Can you expand on that? I remember a saying that gamblers don't gamble.

Mr. SANTINI. Except, perhaps, in the political arena. I think that the common sort of day-to-day experience, both in Atlantic City and in Las Vegas, would demonstrate that for the most part, given all of the entertainment rewards that accompany the gaming experience, they nevertheless end up net losers.

The reason no other nation in the civilized world, and perhaps one or two nations in the uncivilized world, do not tax gaming revenues is that they realize that the Nation itself ends up the net loser of the legal taxable revenues derived. We continue to experiment with a fiction in this Nation that by imposing an obligation of taxing winnings that somehow the Federal Government ends up a net winner. I think the Federal Government ends up a net loser.

Mr. GUARINI. Could you just comment on whether or not you feel that this type of a bill would be an attack on illegal gambling operations in the country?

Mr. SANTINI. Congressman Duncan made an interesting observation in the question he shared with Senator Cannon and that is the Commission's find that, in fact, whether it is in the bookmaking arena, or on the horse track, or in a legalized gaming casino, if there is a tax obligation attached to the gaming activity, the natural inclination of the gambler is to look to see if there is an alternative way he can gamble, and at the same time not have to incur a tax obligation or liability.

If there is an illegal gaming shop in the location, you can bet that a sizable number are going to take the illegal option versus the legal option because there is no tax liability attached, no forms that are part of it, and it is much easier to come and go anonymously rather than have to face tax obligation and reporting obligation.

Mr. GUARINI. So you not only help to build an industry and create jobs, but at the same time it has a second purpose, and that would be to eliminate some illegal gambling that exists in the underworld as we know it.

Mr. SANTINI. Certainly, you substantially reduce the illegal gaming activity in the underworld, as you have described.

Mr. GUARINI. Thank you.

Chairman STARK. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I would like to welcome our colleague before the committee.

It seems to me there are a couple of questions before us, and the overall question is, should or should not legal gambling be allowed in this country. That is not the question before us. That has already been decided. I may personally be opposed to gambling, but that is not the issue here.

The issue is whether or not we should tax that gambling and those activities, and in doing that we should perhaps look at the experience that other countries have had around the world. It seems to me, from what I have heard in testimony here, that it would be better not to tax.

Perhaps the Government would even be better in the long run if it encouraged tourism, and encouraged the developing growth of industries. In the long run the Federal Government perhaps would benefit more by creating a viable economic entity in this industry, and as a result increase employment and participation, and be a net gainer in the process.

Mr. SANTINI. I think you have summarized it very, very well, and I think that observation is a very, very valid one.

Mr. SCHULZE. I thank our colleague for his testimony.

Thank you, Mr. Chairman.

Chairman STARK. Thank you.

Jim, thank you for appearing. It is good to see a member of our California Caucus, albeit an honorary one, before this committee. I appreciate your taking the time to testify.

Mr. SANTINI. Mr. Chairman, I appreciate the time you have given us and I appreciate the number of your constituents who have invested so vigorously in my congressional district. Thank you.

Chairman STARK. Is Congressman Chappell here? I guess not.

At this time, we will recess for about 2 minutes and allow the witnesses, and I number them about eight, to kind of regroup toward the front of the room, and give our reporter a moment for a breather. We will reconvene as soon as you can all get up here, Mr. Stone, Mr. Mulcahy, Mrs. Ringquist, Mr. Schmidt, Mr. Davis, Mr. Murphy, Mr. Keenan, Mr. Brunet, Mr. Fitzgerald, and Mr. Ritchie.

[Recess.]

Chairman STARK. The committee will reconvene.

I will just say to all of you, we have prepared statements and they will all be made part of the record. As you know, for other reasons, the record will be held open waiting for other information. I would ask unanimous consent that you will have until the record closes, which will be at least a week, to submit any further comments you would like, and they will also be made a part of the record.

Again, I want to thank you for accommodating the Chair and the members of the committee in letting us slip people in in front of you. You have been very patient and very kind. I am going to ask you to proceed in the order that you are listed on the list of witnesses, and we will start out with Mr. Stone.

Welcome to the committee, Mr. Stone. I note that you are president of both the Thoroughbred Racing Associations and Churchill Downs, both of which institutions probably still owe me a lot of money, and I will try to get it back some day. You may proceed in any way you see fit.

STATEMENT OF LYNN STONE, PRESIDENT, THOROUGHBRED RACING ASSOCIATIONS, INC., AND PRESIDENT, CHURCHILL DOWNS, ON BEHALF OF THE AMERICAN HORSE COUNCIL

Mr. STONE. Thank you, Mr. Chairman.

I am the president of the Thoroughbred Racing Associations, a trade organization representing 54 of this country's thoroughbred race tracks, and I am president of Churchill Downs, which is the home of the Kentucky Derby. I am also appearing today as a member of the Executive Committee of the American Horse Council. The American Horse Council members include representatives of every segment of the equine industry, including breeder organizations, owner and trainer organizations, and race tracks.

You have heard about IRS studies on compliance in reporting gambling winnings, and those IRS reports show that there was substantial compliance even where no withholding was required.

The studies also reveal that over 56 percent of those who had withholding tax deducted from their payouts at horse tracks filed short form tax returns, or did not itemize deductions. This means that these people had no way of offsetting their wagering losses against their withholding tax liability, and no doubt most of these people were net losers for the year.

It is also worth noting that the IRS studies showed that 36 percent of those persons who paid gambling withholding taxes had adjusted gross incomes of less than $10,000, and nearly 70 percent had adjusted gross incomes of less than $20,000.

I think it is vital to recognize that the population of American parimutuel patrons must, by nature of the parimutuel takeout system, sustain net wagering losses. That is simply because we return less money to that population as payouts after each race than we received as bets before the race. The average bettor must lose money.

Despite these facts, withholding taxes those patrons as if they were net winners. It assumes net winnings without recognizing the fact of net losses. It is a preliminary tax payment assessed on a population that has negative income in this activity. It is fundamentally unfair.

Parimutuel withholding discriminates against the majority of taxpayers who normally use the short form and a zero bracket standard deduction when filing their tax return. Patrons who collect a payout subject to withholding most often know that it doesn't make them a winner in their wagering efforts. They nevertheless have to prove offsetting losses in order to get the money back. That means giving up the short form and itemizing deductions, financially unreasonable for the many lower income people affected by withholding.

IRS standards for substantiating offsetting losses involve extensive recordkeeping and retention of losing tickets. Those documentation requirements are hard to follow and certainly detract from the race track experience as entertainment. It turns racing strictly into a business for our patrons, and that hurts us even more.

I also want to point out that this tax, which is damaging to our industry, generates relatively tiny revenues for the Federal Government. Estimates being submitted to you show that the net revenues from the tax amount to no more than $22 million and possibly as little as $3 million, and that is a far cry from the $500 million that was projected by the Treasury when the tax was considered by Congress in 1976.

The tax really is without a reasonable premise. The payouts affected are part of what amounts to a negative dollar return to our patrons. They do not represent profit or income for that population and, almost always, they amount to no more than a partial offset to moneys already lost through wagering or almost certain to be lost in the future.

It is not surprising that we are losing business because of withholding. The fact that the tax turns tracks into tax collectors in an area that demands no such extraordinary measures, and is unproductive for the Federal Government, makes it all the more unreasonable

Thank you.

[The prepared statement follows:]

STATEMENT OF LYNN STONE, THOROUGHBRED RACING ASSOCIATION, INC.; PRESIDENT, CHURCHILL DOWNS

I am Lynn Stone, president of the Thoroughbred Racing Associations, a trade organization representing 54 of this country's thoroughbred race tracks, and president of Churchill Downs, which many of you will recognize as the home of the Kentucky Derby.

I would like to take my allotted time to discuss the object of withholding -- the pari-mutuel patron and his or her wagering-related tax liability.

I think it is vital to recognize that the population of American pari-mutuel patrons must, by nature of the pari-mutuel system, sustain net wagering losses. That is simply because we return less money to that population as payouts after each race than we received as bets before the race. The average bettor must lose money. The vast majority of pari-mutuel patrons must lose money in their wagering transactions.

Despite these very basic facts, withholding taxes those patrons as if they were net winners. It assumes net winnings, without recognizing the fact of net losses. It is a preliminary tax payment assessed on a population that has negative income in this activity. To me, and to those patrons, that does not make any sense. It is fundamentally unfair.

What's worse, pari-mutuel withholding discriminates against the majority of taxpayers who normally use the short form and its zero-bracket, standard deduction when filing their tax returns. Patrons who collect a payout subject to withholding most often know that it does not make them a winner in their wagering efforts. They nevertheless have to prove offsetting losses in order to get the money back. That means giving up the short form and itemizing deductions, financially unreasonable for the many lower-income people affected by withholding.

Worse yet, IRS standards for substantiating offsetting losses involve extensive record-keeping and retention of losing tickets. Those documentation requirements are hard to follow and certainly detract from the race track experience as entertainment. It turns racing into a business for our patrons, and that hurts us even more.

I would also point out that this tax, so damaging to our industry, generates relatively tiny revenues for the Federal Government. Estimates being submitted to you show that the net revenues from the tax amount to no more than $22 million and possibly as little as $3 million. That is a far cry from the $500 million figure that was projected by Treasury when the tax was considered by Congress in 1976. And it does not take into account the multi-million dollar price the industry is paying because of it.

The tax really is without a reasonable premise. The payouts affected are part of what amounts to a negative dollar return to our patrons. They do not represent profit or income for that population. And, almost always, they amount to no more than a partial offset to monies already lost through wagering or almost certain to be lost in the future.

It is not surprising that we are losing business because of withholding. The fact that the tax turns tracks into tax collectors in an area that demands no such extraordinary measures, and is unproductive for the Federal Government, makes it all the more unreasonable.

Chairman STARK. Thank you very much, Mr. Stone.

Mr. Robert E. Mulcahy III is the executive director of the New Jersey Sports and Exposition Authority, and the director of the Harness Tracks of America.

Mr. Mulcahy, would you like to proceed.

STATEMENT OF ROBERT E. MULCAHY III, EXECUTIVE DIRECTOR, NEW JERSEY SPORTS AND EXPOSITION AUTHORITY, AND MEMBER, BOARD OF DIRECTORS, HARNESS TRACKS OF AMERICA, INC.

Mr. MULCAHY. Thank you, Mr. Chairman.

I am the chief excutive officer of the New Jersey Sports and Exposition Authority, a public authority which operates the Meadowlands Sports Complex.

I would like to take note of the presence of our home State Congressman, Mr. Frank Guarini, and to publicly acknowledge the instrumental role that he played in the middle of the 1970's in the creation of the New Jersey Sports Authority part of which lies in his district and for which we owe him a great debt of gratitude.

Thank you, Frank.

The complex includes both a stadium and an arena, but its financial base is the Meadowlands Racetrack, which houses year-round harness and thoroughbred racing and makes the entire operation economically feasible. In fact, the race track contributes 90 percent of the yearly operating profits of some $49 million.

As you mentioned, I am also here as the director of the Harness Tracks of America, a national trade association representing a majority of U.S. harness racing facilities.

Horse racing is a form of entertainment, one that makes an unusually substantial contribution to the American economy through its extensive agricultural segments. It is also an important source of direct tax revenue for the 30 States that benefit from it.

The industry's financial system—parimutuel wagering—is unique, and the withholding assessment we are considering today is uniquely detrimental to it.

Our revenues, the States' revenues, and the incomes of a half-million horse owners, breeders and others economically tied to the industry, ultimately depend on the financial health of the racetracks and their cash flow. When you take the money out of circulation, as the 20-percent withholding tax does, you cut directly into the industry's financial lifeline. At our operation, The Meadowlands, actual withholding amounts to $5 million per year. The impact does not stop there.

Every dollar at a racetrack is wagered and rewagered an average of 3½ times. This is due to the return of 81 percent of the dollars bet on an event and the subsequent rebetting of those dollars, plus others, on later events. This effect, turned turnover or churn, means that the $5 million withheld from patrons, which cannot be rebet later on, translates into $17.5 million in reduced wagering.

That is a $17.5 million reduction in dollars subject to takeout, and it means that the withholding at The Meadowlands alone costs the State of New Jersey, its Sports Authority and its horse racing community $3.5 million each year. When you add in the effect at

New Jersey's other tracks, you have a total negative impact to the State and its racing community of $7 million per year.

Nationally, the $71 million withheld in 1980 at parimutuel operations, for example, became $250 million in reduced wagering and $50 million in reduced revenue to States and their industries.

That serious revenue burden stands in direct contradiction to what Assistant Secretary Chapoton told you this morning, that the withholding is the least burdensome means of applying tax on the industry's patrons. It may not be a problem for IRS, but it costs the States and our industry $50 million.

He also treated that very lightly, saying that the industry has thrived since 1977 when the tax was introduced and can afford this burden. That is simply not true. In fact, this industry is in serious economic difficulty, compounded in some cases almost fatally, such as the Charlestown example that Congressman Schulze mentioned this morning, by problems caused in part by withholding.

The Assistant Secretary also stated that this is an inconsequential revenue issue, and with that we agree completely. This legislation before you would have virtually no effect on Federal revenues. But Treasury nevertheless says that withholding is necessary because it extracts taxes from people collecting substantial winnings. That is a fallacy.

The essential point being missed or intentionally ignored by Treasury is that a $1,000 payout is not a windfall, nor does it represent substantial winnings. It is part of the normal wagering process and does not usually represent profit.

Withholding attempts to collect Federal tax moneys in amounts Treasury admits are negligible. In the meantime, it has direct, irretrievable costs for our industry that I hope you will consider.

Thank you.

[The prepared statement follows:]

STATEMENT OF ROBERT E. MULCAHY, III, EXECUTIVE DIRECTOR, NEW JERSEY SPORTS AND EXPOSITION AUTHORITY; MEMBER, BOARD OF DIRECTORS, HARNESS TRACKS OF AMERICA, INC.

My name is Robert Mulcahy. I am executive director of the New Jersey Sports and Exposition Authority, a public authority which operates The Meadowlands Sports Complex. The complex includes a stadium and an arena, but its financial base is The Meadowlands Race Track, which houses year-round harness and thoroughbred racing and makes the entire operation economically feasible.

I am also here as a director of Harness Tracks of America, a national trade association representing a majority of United States harness racing facilities.

Horse racing is a form of entertainment, one that makes an unusually substantial contribution to the American economy through its extensive agricultural segments. It is also an important source of direct tax revenue for the 30 states that benefit from it.

The industry's financial system -- pari-mutuel wagering -- is unique, and the withholding assessment we are considering today is uniquely detrimental to it.

The money wagered by patrons as part of their entertainment experience at a track creates a cash flow that serves as the source of state and industry revenues from racing. Every dollar wagered is taxed -- something we call takeout -- at an average rate of about 19%. That takeout is divided as revenue among state treasuries, tracks and horsemen. The remaining 81% is returned to bettors in the form of payouts.

That brief exercise in understanding the pari-mutuel system is necessary if we are to explain why the withholding tax is so unfair and severely damaging to the industry.

Our revenues, the states' revenues, and the incomes of a half million or more horse owners, breeders and others economically tied to the industry ultimately depend on the financial health of race tracks and their cash flow. When you take money out of circulation, as the 20% withholding tax does, you cut directly into the industry's financial lifeline.

At my operation, The Meadowlands, actual withholding amounts to $5 million per year. The impact does not stop there.

Every dollar at a race track is wagered and rewagered an average of 3.5 times. This is due to the return of 81% of the dollars bet on an event and the subsequent rebetting of those dollars, plus others, on later events. This effect, called turnover or churn, means that the $5 million withheld from patrons, which cannot be rebet later on, translates into $17.5 million in reduced wagering. That is a $17.5 million reduction in dollars subject to takeout, and it means that withholding at The Meadowlands alone costs the state of New Jersey, its Sports Authority and its horse racing community $3.5 million each year. When you add in the effect at New Jersey's other tracks, you have a total negative impact on the state and its pari-mutuel industry of $7 million per year.

Nationally, the $71 million withheld in 1980 at pari-mutuel operations, for example, became $250 million in reduced wagering and $50 million in reduced revenue to states and their industry.

I hope you can see the direct, irretrievable revenue cost withholding has on my operation, my state and my industry each year.

Chairman STARK. Thank you very much.

I did want to add at this point, for the record, that all members of the subcommittee who have statements related to any of these bills, without objection, we will have their statement included in the record.

Mr. DUNCAN. Mr. Chairman, at this point, may I also ask unanimous consent that I may submit questions in writing to any member of the panel, as long as the record stays open.

Chairman STARK. Without objection, we would so order, and make that available to any of the other members of the subcommittee.

At this point, Mrs. Helen C. Ringquist, who is president of the Thoroughbred Owners and Breeders Association.

Mrs. Ringquist, you may proceed in any way you see fit.

STATEMENT OF HELEN C. RINGQUIST, PRESIDENT, THOROUGHBRED OWNERS & BREEDERS ASSOCIATION

Mrs. RINGQUIST. Thank you.

I would like to tell you something of the financial structure of the horse racing industry. As owners, we bring to the racetrack horses that are at least 2 years old and are trained to be ridden. They are the actors in the entertainment called horse racing.

At the track we pay for their feed, equipment, care, shelter, security, exercise, and transportation, most of it through a trainer to whom we pay a per diem which can be $25 to $50 per day per horse for every day that he is at the racetrack, whether he is well enough to run or not, whether he runs and wins or loses.

As breeders, we are horse farmers and our crop is foals, the 36,000 registered young thoroughbreds that are born every year. To produce that crop, we buy the blood stock, we buy the broodmares. We pay stud fees to have our mares impregnated, which can be from $500 to $150,000.

We maintain the farms on which they are raised. Horses require pastures. Horses are grazing animals. You cannot raise them in a feedlot.

In Virginia, where we have raised horses, it takes three to four acres of good pasturage per horse. We provide the fencing, feed, machinery, vehicles, grooms, all of the costs that any other sort of farmer has.

I point out to you that our production line is static. A farm cannot move. We pay taxes in our communities. We employ both the educated, the uneducated, the technician, the dropout. We provide housing for them. They, in turn, buy their goods and services in that locality.

Above all we provide open green space. We keep open land in productivity like any other farmer.

We, in general, in broad brush strokes, provide the capital investment in our financial chain. The other source of funds, the cash flow, comes from purses. Purses are a function of wagering. They come from the takeout, the 19 percent of the handle--the amount bet—that is not returned in winnings. A portion of that, roughly 3 percent, is put into a purse fund for which we compete.

Without purses, there is no way for the owners' and breeders' costs to be recouped. There is no chance for financial success, for making our farm pay.

You do see headlines of high priced yearlings, but sales ultimately are keyed to purses. Only the hope of buying or breeding the big horse, which will pay for all the losers, and just like the bettors, we have losers, that is the only thing that motivates us.

Incidentally, the big sales numbers that you read about, many of them go overseas, perhaps 200 million dollars' worth, which helps our balance of trade.

If less dollars are wagered, there is less operating revenue for the tracks, less income to the States and localities. Without tracks, there is no market place for our crop, no arena for our athletes.

Without horse farms, there are no jobs, goods and services, real estate taxes paid, and no beautiful open space which is so important for the illusive quality of life that we cherish.

I think we are a good industry. We are productive in every part of the country. It is estimated that we have an impact of $12 billion.

I urge you to let our major partners in this complex endeavor, the bettors, keep all their winnings until their net is determined, so that our 14,000 members can make our breeding and racing operations productive enough to pay income taxes on our net profits; that all horsemen may earn a living and pay tax on their net earnings, and not tax the bettor on his one long-shot gross profit.

[The prepared statement follows:]

STATEMENT OF HELEN C. RINGQUIST, PRESIDENT, THOROUGHBRED OWNERS AND BREEDERS ASSOCIATION

My name is Helen Ringquist. I am president of the Thoroughbred Owners and Breeders Association, based in New York. I would like to address a few considerations you may not be aware of regarding the horse racing and breeding industry in the United States.

Race tracks are a central link in the horse industry's significant productivity chain. The industry's economic network extends through racing patrons, whose wagers fuel the system; horsemen and women on the backstretch, who make the individual races possible; horse owners, whose investment dollars provide the financial superstructure of the business; and breeders and farm owners, who invest in the development of horses and simultaneously help preserve the agricultural green spaces so vital to our country's well-being.

Because the other segments of the industry depend so heavily on the financial flow generated by the tracks, any economic problems at those tracks are quickly transmitted through the chain. The effects of withholding's cash drain are reflected first in decreased revenues to the tracks, then decreased purse levels, decreased income for owners, and on through the system. The impact is clear and direct.

In addition, an even greater cloud lies on the horizon. It may surprise you to learn that because of the financial problems to which withholding contributes, many of our nation's tracks are in serious danger of being forced to terminate operations. The effect of this on the extensive agribusiness they support would be devastating.

What about that agribusiness? To begin with, there are some 200 major pari-mutuel tracks in this country. Each represents a major, if not the major, contributor to the economy of its local area. A track's economic impact spans salaries and purse distributions; payments for goods and services; local employment; and substantial tax dollars which go directly to local and state government. Almost every track has a multi-million dollar impact on its area.

At the next level, the state level, the numbers grow even more impressive. In New York, for example, the primary annual cash contribution of the racing and breeding industry to the state economy is estimated at $500 million; when you apply the multipliers associated with secondary and tertiary movements of cash through the economy, the impact becomes $1.5 billion.

In Florida, the industry contributes $800 million annually to the state economy; in Pennsylvania, $500 million. In California, the impact exceeds $1 billion, as it does in Kentucky. The list goes on.

Nationally, the economic impact of the horse racing agribusiness may be conservatively estimated at $12 billion. And that does not even begin to evaluate such ancillary benefits as the positive balance of trade generated by American bloodstock on the international market.

The horse racing and breeding industry is a significant American agribusiness. And it is being threatened, fundamentally, by a withholding tax that is wearing away at the financial underpinning of racing and contributing to severe economic problems at our race tracks.

For every patron unfairly taxed, for every dollar wrongly withheld from the wagering stream, our business suffers.

Chairman STARK. Thank you, Mrs. Ringquist. I appreciate your testimony.

The next witness is Charles E. Schmidt, Jr., first vice president of the National Association of State Racing Commissioners, and chairman of the Illinois Racing Board.

Mr. Schmidt, welcome to the committee.

STATEMENT OF CHARLES E. SCHMIDT, JR., FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS, AND CHAIRMAN, ILLINOIS RACING BOARD, ACCOMPANIED BY THOMAS A. DAVIS, COUNSEL, AMERICAN HORSE COUNCIL

Mr. SCHMIDT. Thank you.

I am the chairman of the Illinois Racing Board, and first vice president of the National Association of State Racing Commissioners, which is an association of State agencies empowered to oversee and regulate the parimutuel industries in this country.

Parimutuel sport is a State initiative, currently legislated in numerous jurisdictions as a revenue-producing industry and a popular entertainment form. It is for that reason that the organizations I represent are extremely concerned over parimutuel withholding and the impact it is having.

Recognizing the often overriding considerations of Federal tax policy, I must draw your attention to the fact that withholding as currently constituted is having a direct and negative effect on this area of expressed State interest. It is harming the parimutuel horse, greyhound, jai alai, and off-track betting industries. It is lowering State revenues from those industries. It is negatively affecting the various State programs funded through parimutuels. It is interfering with State anticrime initiatives by increasing the attractiveness of illegal gambling outlets over legal ones.

In 1981, parimutuels accounted for nearly $1 billion in direct tax revenues to the States. As has been pointed out, their importance becomes even greater when considering overall economic impact.

There is no question that withholding reduces wagering, and that reduced wagering translates into less revenue allocated to general State funds or, in some instances, funds applied directly to such areas as education, construction, social programs, and so on.

The actual numbers are even more dramatic. Withholding can be estimated to cost the State of New York and its parimutuel industry $8.75 million per year. It costs New Jersey $7 million annually, Florida $6.3 million, California $6 million, and my State, Illinois, $4 million. A dozen States lose at least $1 million per year because of it.

Other costs may not be as evident. In Illinois, for example, as in a majority of other racing States, the legislature recently was forced to lower the State share of takeout and redirect these funds to the tracks to maintain their financial viability. Withholding is a recognized contributor to the economic problems that have forced these concessions.

The balance between the demands of Federal tax policy and State prerogative can be a delicate one. But in the area we are currently considering one fact is clear: whatever Federal revenues are derived from withholding must necessarily come at the direct expense of the States and their parimutuel industries.

When all the negatives are factored in, that trade-off becomes greatly unbalanced. The tax has built a 5-year record of nonproductiveness in Federal revenue-raising, and an accompanying history of negative State-level impacts.

Thank you.

[The prepared statement of the American Horse Council, Inc., follows:]

STATEMENT OF THE AMERICAN HORSE COUNCIL, INC.

The American Horse Council, Inc. is a national association representing approximately 2.5 million American horsemen and women. Its 160 organizational members include most of the major equine and pari-mutuel organizations in this country. While horse industry participants are primarily represented through these groups, AHC membership is also open to individual professional and pleasure horsemen.

The American Horse Council appreciates this opportunity to express its view on H.R. 4592, proposed legislation to repeal section 3402(q) of the Internal Revenue Code requiring 20% withholding on certain payouts at pari-mutuel operations; amend section 6041 to raise to $10,000 the level at which payouts require information reporting; and amend section 165 to allow three-year carryover and carryback of net gambling losses.

I. WITHHOLDING

BACKGROUND

On May 18, 1977, pursuant to section 3402(q) of the Internal Revenue Code added by section 1207(d) of the Tax Reform Act of 1976, pari-mutuel operations began withholding 20% of payouts of more than $1,000 at odds of at least 300-1. Withholding on such payouts has continued since that date. Affected are race tracks, off-track betting operations and jai alai frontons.

The imposition of withholding on the pari-mutuel industry and its patrons was an outgrowth of Treasury Department and Internal Revenue Service determinations that such on-site tax collections would ensure compliance with tax laws and generate significant, previously uncollected tax revenues for the federal government.

ISSUE

Based as we believe it was on faulty assumptions and unreasonable claims, withholding has ranged far from its original legislative intent in terms of impact and effect. It has wrongfully collected taxes on transactions that ultimately generate no liability and has had serious and persistently damaging effects on the pari-mutuel industry.

It has also reduced state tax revenues and chilled programs such taxes support. Those effects were originally unrecognized or ignored by Treasury in its impact deliberations.

It is the position of the American Horse Council, speaking for the pari-mutuel horse industry, that withholding has uniquely detrimental effects on pari-mutuel operations and the horse industry at large; that it attempts to enforce by extraordinary means tax compliance in an area where no such unusual measures are necessary; that, by negative corollary, it actually confiscates as tax dollars monies that rightfully should be returned to pari-mutuel patrons but which most cannot retrieve under normal circumstances; that it is unproductive for the Federal Government and seriously counterproductive for States and their pari-mutuel industries; and that it increases the advantages of illegal bookmakers over legal wagering outlets and may accrue to the benefit of organized crime.

This statement outlines those issues and offers what we believe to be reasoned, factual and sharply defined arguments in favor of repeal of section 3402(q) of the Internal Revenue Code.

I. Withholding is based on wrongful assumptions and is unproductive for the Federal Government.

Withholding on pari-mutuel payouts appears to be a derivative of federal withholding on wages, a preliminary tax collection designed to secure tax funds and ensure enforcement of the Internal Revenue Code requirement (Section 61 IRC) that "all income from whatever source derived" be included in gross income and taxed accordingly.

In the case of pari-mutuel payouts, the withholding application is based on assumptions that (1) there is net income and a basis for tax liability; (2) there is a need to ensure compliance; and (3) there are substantial Federal Government revenues to be gained by such an application.

While those assumptions may apply in other areas, they are seriously inaccurate and misleading in the area of pari-mutuel wagering and have been used indiscriminately to support the claim that withholding is necessary and reasonable.

Income

The assumption that there is net income for any more than a small segment of participants in the pari-mutuel wagering system is a basic falsehood disproven by a fundamental understanding of the pari-mutuel process.

The phrase "pari-mutuel" is itself a French term meaning "among ourselves" as descriptive of the wagering process. Pari-mutuel patrons compete against each other, with the race track or pari-mutuel facility acting as a moneychanger (redistributor). A portion of each wagering pool is removed as "takeout" -- monies divided as revenues among State and local governments, horsemen and tracks -- and the remainder redistributed among the patrons.

The effect of this takeout process is to leave a lessening amount for redistribution to patrons. For every dollar wagered at a race track or pari-mutuel facility, an average 81 cents is returned to bettors. When spread over time and probability, the result is that the majority of patrons under normal circumstances must sustain net losses. This fact has been borne out repeatedly in examinations of the industry.

By definition, the takeout aspect of pari-mutuel wagering negates the prospect of net winnings for all but a small percentage of participants and ensures that the patron population as a whole will experience net losses.

Tax Liability and Compliance

Claims of tax liability and the need to ensure compliance cannot, as shown, be based upon general assumptions of widespread net income in the pari-mutuel area. The majority of pari-mutuel participants cannot and will not generate such a liability, and the question of compliance requirements not being met therefore becomes moot in most circumstances.

The need for extraordinary compliance measures, based on an assumption of non-compliance, has never been demonstrated and cannot be. Moreover, it should be recognized that the payouts in question, those of $1,000 or more at odds of at least 300-1, wrongly characterized as "windfall profits", are in fact simply part of the normal wagering process and are not necessarily profits. The majority of those payouts will be offset, to a large extent or completely, by the inevitable losses experienced by average patrons over a period of time. The $1,000 figure, though large by some measurements, is much smaller by standards of the pari-mutuel system, in which the average patron will wager roughly $150 per race day. Thus payouts of $1,000 or more (now subject to withholding) may be rapidly offset by future losses, which are a virtual certainty for most patrons, and may just as easily represent an offset to significant losses already sustained (which received no tax treatment).

Tax liability and the need for compliance withholding are faulty assumptions in the pari-mutuel process. This issue is further addressed in Sections II and III.

Revenues

When originally proposed, pari-mutuel withholding was projected by IRS to carry the potential of $500 million in annual revenues for the Federal Government. While that estimate may have fueled Congressional interest in the matter, it was almost immediately reduced to $110 million. Even this figure remains undocumented and misleading.

The assumption of $110 million in Federal Government revenues reflects a raw withholding estimate -- the amount to be collected on-site -- and does not take into account the legitimate offsetting losses generated that significantly reduce the lawful revenue impact.

Withholding at pari-mutuel facilities in 1980 amounted to $71.3 million. Of that amount, it can be estimated that less than $10 million represented legitimate tax liability for those few patrons who generated net winnings. And there is no evidence to suggest that more than an insignificant portion of this already tiny revenue figure would not have been accounted for under voluntary tax compliance.

The claim of substantial Federal Government revenues from pari-mutuel withholding has not been borne out by the reality of collection. More importantly, IRS efforts to document withholding's effectiveness have consistently failed to address the costs involved for individual taxpayers and the industry at large. Those costs, discussed below, reveal withholding to be seriously counterproductive and a detrimental intervention into the business relationship between the pari-mutuel industry and its customer.

Far from its legislative intent, withholding has not generated formerly uncollected tax revenues for the Federal Government and has instead produced unwarranted and harmful side effects.

II. Withholding is confiscatory and discriminatory.

Based on a series of faulty assumptions involving income, tax liability, compliance and Federal Government revenues, withholding on pari-mutuel payouts has developed not as an effective means of tax collection but rather as a confiscatory and discriminatory excise.

Under current law, a bettor may deduct losses only to the extent that they offset gains. In an industry that by its nature will generate more losses than gains for its patrons, this produces a fundamentally unfair tax situation wherein losses alone receive no tax treatment while gains are fully taxable and must be offset.

In the meantime, IRS standards for substantiation of losses are so difficult to meet that the average patron cannot or will not be able to produce the necessary documentation without dramatically altering his approach to pari-mutuel entertainment. Gains, as reflected by payouts subject to reporting ($600-999) and withholding, are difficult or impossible for the average patron to offset, despite the fact that under normal circumstances his losses in a calendar year will outweigh the value of the gain. American Horse Council studies show that of patrons receiving payouts subject to withholding, over 85% report they will conclude the year as net losers in their pari-mutuel transactions.

The problem of pari-mutuel withholding is compounded by the fact that substantiation of losses for those able to meet IRS standards requires the taxpayer to forfeit use of the standard or zero-bracket deduction. In the common situation where a taxpayer of modest means is affected by withholding on a payout, the forfeiture of the standard deduction in order to claim offsetting losses would most often be a financial disaster. American Horse Council studies have shown that nearly 60% of respondents who were entitled to a refund from 20% withholding either could not give up the standard deduction for financial reasons (they did not have other itemized deductions needed to make such a move sensible) or were unable to substantiate offsetting losses under difficult IRS standards.

Furthermore, even if the bettor can substantiate and itemize all his gambling losses, he may be subject to the alternative minimum tax on his winnings because the losses are treated as "excess itemized deductions" rather than as proper offsets to those winnings.

The individual attending pari-mutuel events who is affected by withholding at some point is therefore likely to be confronted with these considerations:

-- He will be a net loser for the year, yet is being forced to give up 20% of a payout to early and unwarranted tax collection.

-- In order to gain the rightful refund, he will have to give up the standard deduction and itemize deductions. He will not be able to generate or substantiate enough other itemized deductions to warrant forfeiture of the standard deduction and will therefore find it economically unreasonable to do so. If he does do so, he must meet extremely difficult standards of wagering loss substantiation set by IRS.

In too many cases, the choice will be to surrender to the Federal Government the amount of the withholding because of the complex and discriminatory recapture process. This amounts to a form of negative taxation that in concept and practice runs counter to the ideals of the tax system.

III. The pari-mutuel industry is uniquely damaged by withholding's incursion into the wagering stream.

Withholding removed $71.3 million from the pari-mutuel process in 1980. Since its inception in 1977, withholding has drained away more than $275 million in collections.

Because the pari-mutuel industry relies on wagering, cash return and rewagering to sustain its financial base, the impact of withholding on pari-mutuel operations is far greater than those numbers would suggest.

To begin with, each dollar at a race track is rewagered an average of 3.5 times. That statistic derives from return of 81% of all wagers to patrons as payouts and the subsequent rebetting of those same dollars. Removal of $1 from the wagering stream by artificial means translates into 3.5 times that amount, or $3.50, in reduced overall wagering due to this "churn" factor. The net effect of the reduced wagering is fewer dollars being subjected to the 19% takeout, and therefore fewer dollars going as revenues to State and local governments, horsemen and race tracks.

In the case of withholding, the toll is dramatic. The subtraction of $71.3 million from the pari-mutuel process in 1980 translated into a huge $250 million reduction in wagering nationwide. The aggregate cost to the revenue partners that depend on wagering for income was at least $50 million last year alone and has totaled over $200 million since inception of the tax.

In order to fully understand this multiplier effect and the net damage inflicted by withholding, it must be recognized that cash flow has the same basic importance for the pari-mutuel industry that it does for the American financial system. Much as dollars flow through Wall Street as a commodity subject to constant transfer and reuse, so dollars at a race track serve to fuel the basic pari-mutuel system. In both worlds, the financial flow in general is more important than the nature of the individual transactions, and any breakdown subjects the entire system to a series of correlated shocks that have a serious effect.

To subject financial markets such as stock exchanges to immediate on-site withholding would be devastating, simply because the effect of removing 20% of profitable transaction values, regardless of overall net profit, would seriously reduce the system's vital cash flow. The impact of withholding on the pari-mutuel system is much the same. Removing dollars as taxes (with or without year-end liability) cuts into the cash flow on which the process is based. The direct repercussions, as the multiplier effect shows, are much more significant than the raw amount withheld.

Pari-mutuel patrons depend on the return of wagering dollars as payouts to form the base of future wagers. They cannot consistently supply new dollars to the process to replace those removed artificially by the withholding tax. Thus withholding creates a gap in the wagering stream. It subtracts a 3.5 multiple of itself from the system, and thereby interrupts the cash flow that forms the industry's financial base.

Withholding also intervenes in the business relationship between the industry and its patrons, which depends in great part on the general belief of those patrons that they are receiving a fair opportunity in the wagering process. The perception (and reality) of excessive taxation created by withholding acts as a serious disincentive, as does the actual physical administration of the tax.

IV. Withholding is seriously counterproductive for States and their pari-mutuel industries.

Thirty states conduct pari-mutuel events and derive revenues from the industry. Their interests are directly affected -- negatively and substantially -- by withholding.

The $250 million negative wagering impact of withholding translated in 1980 into an aggregate $50 million reduction in revenues to States and their pari-mutuel industries. As previously noted, withholding has cost these partners over $200 million since 1977, and has had further negative effects on the breeding and related industry segments whose well-being depends on the health of the race tracks.

On the state level, takeout revenues from racing are added to general revenue funds and used accordingly, or in some instances are earmarked for direct use in such areas as education, construction, social programs and so on.

On the industry level, takeout revenues (1) form the base of purse funds, the monies distributed to horsemen and horseowners that represent the heart of the horse business; and (2) provide return on investment and reinvestment capital for track operators. In both areas, the revenues are far from abundant and are the subject of constant concern.

An excellent example of the interplay between State and industry, and the dramatically negative impact withholding can have on that relationship, came in West Virginia recently. Already under extreme hardship to turn a profit from racing operations, Charles Town Race Track saw its bottom line dwindle to desperate levels with the onset of Federal withholding in 1977. In that year, wagering at the track dropped significantly, prompted by withholding's cut from the wagering stream. That development was accompanied by reduced purses, corresponding poor quality racing and the real threat that the thoroughbred operation would be forced to close down -- a disastrous event for the local economy and the thousands of horsemen and employees drawing their livelihoods from the track.

Charles Town was confronted with two alternatives: obtain tax relief from the State or terminate racing operations. While withholding was not the sole factor which led to this situation, its impact helped necessitate State concessions in order to save the operation. The State agreed to divert a major portion of its revenue from the pari-mutuel takeout to the track to salvage racing at Charles Town. At the first stage, withholding reduced wagering, with a corresponding decrease in revenues for the State, horsemen and the track; at the second stage, it forced the State to redirect its revenues to the industry, thereby further reducing revenue to the State Treasury.

Over the past four years, a majority of States with pari-mutuel industries have been forced to redirect revenues to the tracks to maintain their current financial viability and ensure their future existence. Withholding has been a noted contributor to the difficulties that produced this condition, worsening existing problems and forcing financial commitments to patch them.

Recognizing the State-level impact of withholding, the reduced revenue and the ultimate need for the States to compensate for it in order to preserve their pari-mutuel industries, the national organization representing the State regulatory agencies that govern racing across the nation has moved to formally protest Federal withholding. In resolution form, the National Association of State Racing Commissioners joined with "the Commissions of the respective States which derive substantial economic, social and agricultural benefits from the industry to petition and urge the Congress of the United States to repeal this withholding burden on the millions of people who participate in pari-mutuel sports."

The resolution, drafted and adopted at the annual convention of the NASRC, concludes with the exhortation that "our Governors, our State Legislatures and our U. S. Congressional delegations ... join with the racing commissioners in a commitment to insure that the confiscatory and discriminatory tax policy presently applied to the pari-mutuel industry not be permitted to continue to damage the industry and the State revenues derived from it." (A copy of the resolution is attached.)

Withholding has weakened the financial condition of pari-mutuel operations in every State that houses the industry. It has a directly negative effect on State revenues and a secondary impact of requiring State action to alleviate the economic problems it causes for race tracks and other pari-mutuel facilities. Whatever Federal revenues are derived from withholding must necessarily come at the expense of the States and their industry.

V. Withholding's negative impact damages a focal point of a major American agribusiness.

Race tracks are a focal point of the huge American horse agribusiness. Their well-being is of vital importance to an economic chain that includes hundreds of thousands of horsemen and industry employees, horse owners, breeders, farm owners and others whose livelihoods are related to the industry. For example, there are 350,000 people licensed to work at race tracks. Farms engaged in breeding horses for the race track employed about 80,000 people in 1980 to produce approximately 50,000 foals.

Tracks are also key contributors to the economies of their local areas, often generating through employee salaries, horsemen's purses, goods and services purchases and local tax revenues a substantial portion of the local cash flow. The individual economic impacts of race tracks vary, but most can be estimated to generate an impact of at least $30 million on their areas. Larger operations may exceed $100 million.

The national economic impact of the racing industry is difficult to estimate but is thought to exceed $10 billion when calculated to include farmland investment and other related elements. Direct revenue to government approaches $1 billion annually; purse distributions to horsemen account for another $700 million alone. Exports of horses during 1980 came to over $200 million, contributing to the vital export balance generated by American agriculture. Much of this export trade results from the dominance of the U.S. bloodstock industry -- a dominance that could well be jeopardized by a declining horse racing industry in this country.

The substantial horse racing agribusiness keys upon race tracks as the central links in the economic chain, and each segment feels the impact of any financial dislocations at that level.

Withholding's $50 million annual revenue cost to States and their pari-mutuel industries is carried through each level in successively damaging fashion, transmitting potential reductions in employment and salary distributions, lowered investment attractiveness due to downgraded economic prospects, and so forth. The effects may not be immediately evident but must eventually be passed down the line.

As previously noted, the effect of cash removal is uniquely detrimental to the pari-mutuel industry. By the same token, the ripple effects of such a shortfall at the track are substantial as well. Withholding therefore has a serious and pervasive impact on the financial chain of the racing agribusiness, centering on the race tracks. In combination with other economic factors such as inflation, it is eroding the financial underpinnings of the industry and jeopardizing the future of a vibrant and important contributor to the American economy.

VI. Withholding increases the advantages of illegal bookmakers and may accrue to the benefit of organized crime.

There are certain natural advantages which tend to encourage some bettors, particularly those who wager large amounts, to deal with illegal bookmakers. Among these:

- Illegal sources accept telephone wagers, whereas the majority of legal sources are prevented by law from doing so;
- Illegal sources extend credit to their customers, whereas all pari-mutuel systems are prevented by law from doing so; and
- Illegal sources do not report any winnings to the Federal and/or State government, which legal sources must.

One of the primary purposes ascribed to the legalization of State regulated wagering activities is to combat illegal betting operations. As the Commission for the Review of the National Policy Toward Gambling noted in its report to Congress in 1976, "[T]he Commission believes that Congress should take great care in the exercise of its taxing powers so as not arbitrarily to discourage State policies. Not only might the Federal government stifle State initiatives in raising revenues, but Federal taxes on State gambling operations may render State governments incapable of competing with those illegal games they seek as a matter of State policy to eliminate."

By creating and imposing 20% withholding, the Federal Government has provided another incentive for those so inclined to wager with illegal bookmakers. The dollars funneled to these illegal sources may be expected to accrue to the ultimate benefit of organized crime.

In addition to benefiting those least deserving of such benefits, withholding drives to them bettors who would normally make their substantial wagers at the track.

The important point is that withholding cannot serve as an inducement to bring patrons into the legal pari-mutuel system; it can and does drive some of them out of it by adding yet another tax liability to the legal avenue.

SUMMARY

The 20% Federal withholding on pari-mutuel payouts of $1,000 or more at odds of at least 300-1

-- is based on faulty and misleading assumptions of income, tax liability and Federal Government revenues;

-- is confiscatory and discriminatory, most often collecting as tax dollars shares of payouts that do not generate tax liability and making it exceedingly difficult for the taxpayers to retrieve those monies;

-- has a uniquely damaging effect on the pari-mutuel industry's wagering stream and its vital cash flow;

-- removed $71.3 million from that stream in 1980, translating into a reduction in national wagering of some $250 million;

-- is seriously counterproductive for States and their pari-mutuel industries, which lost an aggregate $50 million in each of the past four years due to the collection;

-- damages the financial underpinnings of the industry and by corollary the economic prospects of one of America's most important agribusinesses; and

-- accrues to the benefit of illegal bookmakers and organized crime by making legal wagering avenues substantially less attractive than illegal ones.

For those reasons, the American Horse Council vigorously supports repeal of section 3402(q) of the Internal Revenue Code.

II. REPORTING

BACKGROUND

Section 6041 of the Internal Revenue Code provides that gambling payouts of $600 or more at odds of at least 300-1 must be reported through the filing of information returns. As with instances of withholding, reporting carries administrative requirements for pari-mutuel facilities involving completion of forms and explanations to patrons.

ISSUE

IRS studies have shown that the bulk of legitimate income tax revenues from gambling winnings, coupled with the highest degree of individual compliance, comes from the category of payouts of $10,000 or more. This draws directly from the fact that, from the $10,000 level down to the $600 base at which reporting begins, payoffs are less and less likely to generate a net tax liability.

While the smaller payouts are significantly less productive for the Federal government in terms of tax revenues, their documentation is much more burdensome for the pari-mutuel industry (and state lotteries) due to the increased volume and serious administrative problems involved. The $600 level fails to reasonably pursue the goal of the reporting system -- to ensure payment of tax where liability exists -- but imposes a cumbersome and costly administrative process upon the industry, to the discomfort of its patrons and the detriment of state and industry revenues.

Raising the reporting threshold to $10,000, as this legislation provides and a cost/benefit analysis would suggest, would reduce the burdens and inherent costs of the reporting system and make virtual certainty of covering transactions that net out to real tax liability. The proposed amendment of Section 6041 would thus redirect the thrust of the system toward the most effective and productive areas.

Amendment would also further the goal of reducing the advantages illegal operators hold over legal ones by eliminating the unreasonable tax treatment of smaller payouts.

III. CARRYOVER/CARRYBACK OF LOSSES

BACKGROUND

Section 165(d) of the Internal Revenue Code allows a specific deduction for gambling losses up to but not exceeding the extent of gambling winnings. The taxpayer properly declaring winnings in any year is not permitted to carry forward or carry back losses from previous or subsequent years to offset winning years, if any.

ISSUE

Though only a small percentage of pari-mutuel patrons will generate a net tax liability in any year, those that do are unable to use properly documented losses from past years to offset those net gains. And future losses will also receive no tax treatment, except as they offset same-year winnings.

This situation (coupled with the low reporting level considerations documented above) discriminates against patrons placing legal wagers and works to the benefit of illegal outlets, whose patrons need not be concerned about offsetting gains because those gains will not be reported to IRS by the operators in the first place.

The three-year carryover/carryback provision of this legislation addresses this inequity by enabling taxpayers to receive credit for their losses. This would serve to further reduce the practical incentives for concealing gambling winnings and placing wagers through illegal outlets.

DIRECT REVENUE COSTS OF PARI-MUTUEL WITHHOLDING
(Based on 1980 Figures)

State	Annual Pari-Mutuel Withholding	Resulting Decrease In Wagering	Est. Annual Revenue Cost to States, Pari-Mutuel Industry
New York	$12,500,000	$43,750,000	$8,750,000
New Jersey	10,000,000	35,000,000	7,000,000
Florida	9,000,000	31,500,000	6,300,000
California	8,500,000	29,750,000	5,950,000
Illinois	5,800,000	20,300,000	4,060,000
Pennsylvania	3,200,000	11,200,000	2,240,000
Connecticut	2,600,000	9,100,000	1,820,000
Massachusetts	2,500,000	8,750,000	1,750,000
Ohio	2,200,000	7,700,000	1,540,000
Louisiana	2,000,000	7,000,000	1,400,000
Michigan	2,000,000	7,000,000	1,400,000
Maryland	1,500,000	5,250,000	1,050,000
West Virginia	1,200,000	4,200,000	840,000
Arizona	1,000,000	3,500,000	700,000
Colorado	900,000	3,150,000	630,000
Rhode Island	800,000	2,800,000	560,000
Alabama	700,000	2,450,000	490,000
Arkansas	700,000	2,450,000	490,000
New Hampshire	650,000	2,275,000	455,000
Washington	600,000	2,100,000	420,000
Kentucky	550,000	1,925,000	385,000
Nebraska	550,000	1,925,000	385,000
New Mexico	500,000	1,750,000	350,000
Oregon	500,000	1,750,000	350,000
Delaware	350,000	1,225,000	245,000
South Dakota	200,000	700,000	140,000
Maine	150,000	525,000	105,000
Vermont	90,000	315,000	63,000
Idaho	50,000	175,000	35,000
Montana	40,000	140,000	28,000
Nevada	5,000	17,500	3,500
Wyoming	5,000	17,500	3,500
	$71,340,000	$249,690,000	$49,938,000

The above computations are based on figures from pari-mutuel thoroughbred, standardbred, quarter horse and greyhound racing, Off-Track Betting (New York and Connecticut) and jai alai. The decrease in pari-mutuel wagering caused by withholding is generated by applying a 3.5 churn factor (average rewagering of dollars returned to patrons) to amounts withheld; revenue cost to States and the industry assumes an average 20% takeout (a share subtracted from all pari-mutuel pools accounting for State and industry revenues) on those dollars.

Chairman **Stark**. Thank you very much, Mr. Schmidt.

Our next witness is Joseph E. Murphy, international vice president of the Service Employees International Union.

STATEMENT OF JOSEPH E. MURPHY, INTERNATIONAL VICE PRESIDENT, SERVICE EMPLOYEES INTERNATIONAL UNION, AFL-CIO, ACCOMPANIED BY ROBERT E. JULIANO, LEGISLATIVE REPRESENTATIVE, HOTEL EMPLOYEES & RESTAURANT INTERNATIONAL UNION

Mr. **Murphy**. Thank you, Mr. Chairman, and members of the committee.

My name is Joseph E. Murphy, international vice president of the Service Employees International Union, AFL-CIO, which represents over 20,000 workers in the racing industry. As the largest representative of racetrack workers, the SEIU joins the other members of this panel in endorsing H.R. 4592.

The current tax treatment of parimutuel winnings has had a seriously detrimental effect on State governments, the racing industry, and, therefore, our membership. The withholding tax cuts into the amounts of revenue that a typical patron regenerates during a day at the races and throughout the racing season. This automatically translates into reduced handle. As handle goes down, so does State and track revenue, and so does the number of jobs.

When tracks are unable to turn a profit, they have no choice but to shut down, forcing hundreds of individuals to hunt for work in the midst of a recession. The SEIU is all too familiar with such dire circumstances. The imposition of the 20-percent Federal tax and withholding requirements was just enough to push the faltering Charles Town Race Track to the brink of financial ruin midway through the 1977 racing season.

Within the boarded-up facilities, a congregation of our 300 members gathered to anxiously ponder their fate. In bold letters, a "closed" sign ominously hung above the entrance. The shutdown directly affected 1,000 jobs. Many more jobs throughout the community would suffer indirect economic effects. Fortunately, the State of West Virginia agreed to channel some of its own revenues back into the industry. The track reopened, saving jobs and the local economy.

The Charles Town example is not unique. Track closings are threatening the livelihood of workers throughout the country. Centennial Racetrack in Littleton, Colo., has just been sold to a land developer and will close at the end of the 1983 season. Over 400 workers will be directly affected, including 200 of our members. Two tracks in Kentucky, suffering from a dismal 1981 season, are threatening to shut down. Realizing the severity of the situation, the State has agreed to come to their aid, saving another 300 jobs.

The SEIU is relieved to obtain such assistance, but we are also realistic. We know we cannot continue to rely upon the States for help. State governments are suffering from their own fiscal crises. Bailout funds will no longer be available. We in the racing industry must find another form of relief.

It seems only fitting that this relief come from the Federal Government. The Federal Government must seek ways to promote industry growth, not ways which curtail it. The Federal Government must help to maintain employment, not contribute to the 10 million persons that are currently unemployed in this country.

The SEIU firmly believes that the passage of H.R. 4592 will provide that relief. We hope that the members of this subcommittee will recognize this bill as a way to save jobs not only at the racetracks themselves but throughout the communities they serve.

Thank you.

[An attachment to the prepared statement, and the statement of Robert E. Juliano, follow:]

ATTACHMENT TO THE STATEMENT OF JOSEPH E. MURPHY

Since the Federal tax withholding went into effect in 1977, attendance at the tracks for horse racing has gone down while attendance at the dog tracks has hovered at the 20 million mark.

Pari-mutuel turnover in both industries increased from 1977 to 1980 but at a significantly lower rate than that of inflation.

Thoroughbred, Harness, Quarter Horse & Mixed Racing

	Attendance	Turnover
1977	75,986,542	$ 9,697,699,320
1978	75,324,441	10,028,828,773
1979	72,783,076	10,727,974,557
1980	74,689,625	11,218,028,761

Greyhound Racing

	Attendance	Turnover
1977	19,985,107	$ 1,591,120,026
1978	20,272,047	1,746,169,659
1979	21,127,396	1,985,455,334
1980	20,874,303	2,063,836,126

Rate of Increase in Turnover and Inflation

1977 - 1980

	Horse Racing	Greyhound Racing	CPI-W
Rate of Change	15.7%	29.7%	36.1%

STATEMENT OF ROBERT E. JULIANO, LEGISLATIVE REPRESENTATIVE, HOTEL EMPLOYEES & RESTAURANT EMPLOYEES INTERNATIONAL UNION

MR. CHAIRMAN, ON BEHALF OF OUR GENERAL PRESIDENT, EDWARD T. HANLEY, AND THE 450,000 MEMBERS WE PROUDLY REPRESENT, MAY I SAY WHAT A PLEASURE IT IS TO APPEAR BEFORE THIS DISTINGUISHED SUBCOMMITTEE REGARDING H.R. 4592 TO DISCUSS A MATTER OF VITAL IMPORTANCE TO OUR UNION AND THE TOURISM INDUSTRY.

THE HOTEL EMPLOYEES AND RESTAURANT EMPLOYEES INTERNATIONAL UNION REPRESENTS THOUSANDS OF MEMBERS WHO ARE EMPLOYED BY THE GAMING INDUSTRY IN BOTH ATLANTIC CITY, NEW JERSEY AND THE STATE OF NEVADA. WE ARE BY FAR THE LARGEST UNION IN NEVADA, AND OUR MEMBERS CONSTITUTE APPROXIMATELY 10% OF THE STATE'S NON-AGRICULTURAL LABOR FORCE. WE ARE RAPIDLY GROWING IN ATLANTIC CITY, NEW JERSEY, BUT HAVE NOWHERE REACHED OUR POTENTIAL, SINCE HIGH INTEREST RATES AND GENERAL ECONOMIC CONDITIONS HAVE CAUSED SOME MAJOR CORPORATIONS TO HOLD UP THEIR DECISION TO BUILD NEW FACILITIES. NEEDLESS TO SAY, WITHOUT THE ATTRACTION OF GAMING IN THESE AREAS, THESE JOBS WOULD NOT EXIST. NOR WOULD THE POSSIBILITY FOR ADDITIONAL JOBS, WHICH TRANSLATES TO POTENTIALLY MORE MEMBERS FOR US. AS A RESULT, THE ECONOMIC HEALTH OF THE GAMING INDUSTRY IS A MATTER OF GREAT CONCERN TO MY UNION.

ESPECIALLY DURING THIS DIFFICULT TIME OF ECONOMIC UNCERTAINTY, HIGH INTEREST RATES, HIGH UNEMPLOYMENT, AND A STILL TOO HIGH INFLATION RATE, WE ARE MORE CONCERNED THAN EVER ABOUT PROTECTING OUR MEMBER'S JOBS AND THEIR LIVELIHOOD BECAUSE THE TOURISM INDUSTRY IS BASICALLY A BAROMETER OF THE OVERALL NATIONAL ECONOMY.

WE ARE CONFIDENT THAT THE CONGRESS, AND ESPECIALLY THE MEMBERS OF THIS DISTINGUISHED SUBCOMMITTEE AND FULL COMMITTEE, SHARE OUR CONCERN BECAUSE WE REPRESENT FEMALES, MINORITIES, SEMI-SKILLED AND UNSKILLED PEOPLE, AS WELL AS TRUE PROFESSIONALS IN THEIR RESPECTIVE CRAFTS. ANY FURTHER DECLINE IN THE NATIONAL ECONOMY WOULD RESULT IN MAJOR UNEMPLOYMENT, BECAUSE OUR INDSUTRY IS HIGHLY LABOR INTENSIVE. IF IN FACT MY MEMBERS, AND OTHERS IN THE INDUSTRY WO ARE NOT ORGANIZED, LOSE THEIR JOBS, THESE PEOPLE WILL GO FROM PRODUCTIVE CITIZENS AND TAXPAYERS TO THE ROLLS OF UNEMPLOYMENT AND WELFARE. WE KNOW THAT OUR ECONOMY CANNOT STAND THAT KIND OF A DRAIN, AND IT MAKES THE REDUCTION OF THE DEFICIT THAT MUCH MORE DIFFICULT TO ACHIEVE.

THEREFORE, ANY LEGITIMATE METHOD WE CAN UTILIZE TO SAVE OUR MEMBERS JOBS IS, WE FEEL, BOTH IN THEIR INTEREST AS WELL AS IN THE COUNTRY'S INTEREST. THUS WE ARE PLEASED TO TESTIFY BEFORE THIS DISTINGUISHED SUBCOMMITTEE TODAY CONCERNING THE EXISTING FEDERAL TAX POLICIES REGARDING LEGAL GAMING PAYOUTS. IT IS OUR FEELING THAT THE CURRENT POLICY IS HAVING AN INHIBITING EFFECT ON THE GROWTH OF THE GAMING INDUSTRY. AS YOU HAVE HEARD FROM OTHERS HERE TODAY, FEDERAL TAX POLICIES DISCOURAGE PLAYERS FROM PATRONIZING LEGAL GAMING AND BETTING AND ENCOURAGE ILLEGAL GAMBLING. THE END RESULT IS TO DRIVE MONEY OUT OF LEGAL GAMBLING INTO ILLEGAL CHANNELS.

SUCH FEDERAL TAX POLICIES ENDANGER THE JOB SECURITY OF OUR MEMBERS AND THREATEN TO ELIMINATE SIGNIFICANT NUMBERS OF UNION JOBS IN THE FUTURE UNLESS THEY ARE REFORMED. OUR MEMBERS ARE WHOLLY DEPENDENT ON THE WILLINGNESS OF PEOPLE TO GAMBLE LEGALLY FOR THEIR LIVELIHOOD.

AN INDEPENDENT STUDY OF NEVADA GAMING WINNERS SHOWS AN AVERAGE REDUCTION IN LEGAL GAMBLING OF 15% FOR PATRONS AFFECTED BY FEDERAL REPORTING REQUIREMENTS. THIS DECREASE IN LEGAL GAMBLING TRANSLATES INTO REDUCED UNION EMPLOYMENT. THE SAME INDEPENDENT STUDY ESTIMATES THAT BY 1987, IF THESE FEDERAL TAX POLICIES ARE NOT CHANGED, THE REDUCTION IN LEGAL GAMBLING THESE FEDERAL POLICIES CAUSE WILL ELIMINATE 1,000 NEVADA GAMING INDUSTRY JOBS, AND AN ADDITIONAL 2,200 JOBS IN RELATED INDUSTRIES. THERE WILL BE A DIRECT LOSS OF $10 MILLION IN SALARIES, TO SAY NOTHING OF THE MUCH GREATER LOSS TO NEVADA'S GENERAL ECONOMY THE ELIMINATION OF THESE JOBS WOULD ENTAIL.

THE TAX REFORMS CONTAINED IN H.R. 4592 WOULD PREVENT THIS LOSS OF JOBS AND END THE PRESENT THREAT TO OUR UNION MEMBERS' JOB SECURITY CREATED BY THE EXISTING FEDERAL TAX TREATMENT OF LEGAL PAYOUTS. ON BEHALF OF THE 450,000 MEMBERS OF THE HOTEL EMPLOYEES AND RESTAURANT EMPLOYEES INTERNATIONAL UNION, I RESPECTFULLY URGE YOU TO SUPPORT H.R.4592 AND REPORT IT FAVORABLY FROM COMMITTEE. THE ENACTMENT OF THIS MUCH NEEDED TAX REFORM INTO LAW WOULD BRING SOME STABILITY INTO AN AREA THAT IS REPLETE WITH UNCERTAINTY.

THANK YOU. IF THERE ARE ANY QUESTIONS I WILL BE GLAD TO ANSWER THEM.

Chairman **Stark**. Thank you very much, Mr. Murphy.

Our next witness is John F. Keenan, president and chairman of the board of directors of the New York City Off-Track Betting Corp.

Mr. Keenan, you may proceed in any way you like.

STATEMENT OF JOHN F. KEENAN, PRESIDENT AND CHAIRMAN, NEW YORK CITY OFF-TRACK BETTING CORP., ON BEHALF OF THE NATIONAL ASSOCIATION OF OFF-TRACK BETTING, INC.

Mr. **Keenan**. Thank you, Mr. Chairman.

It is a privilege to appear before your distinguished subcommittee this afternoon on behalf of the governmental off-track betting services of New York and Connecticut.

The seven off-track betting operations, six in New York and one in Connecticut, exist for State and local government. In our State, off-track betting is operated solely for the public benefit, to accommodate large numbers of our citizens who, before off-track betting, bet illegally with bookmakers.

Off-track betting came into being only after extensive public debate. In New York City there was an overwhelmingly favorable referendum on the subject. The statutory purposes of off-track betting are to raise money for local and State governments and to curb illegal betting on horseraces. Off-track betting is an imaginative step taken by these two States to fund government and to reduce illicit gambling by diverting off-track wagers from criminal channels and directing this revenue to constructive use.

Since its inception, off-track betting has raised over $1 billion for State and local governments, and more than a half billion dollars for the racing industry. Currently, OTB distributes $161 million annually to State and local government, and $85 million annually to the racing industry.

The basic reason for our support of H.R. 4592 is that withholding from legal parimutuel payouts has reduced OTB's ability to carry out our statutory purposes.

If you were to profile our average bettor, you would find that he is a married male, over 40, probably a blue-collar worker who earns about $21,000 a year. I can tell you that he deeply resents withholding.

You know and I know that under Federal law, taxpayers can deduct gambling losses if they itemize deductions to the extent of their winnings, but most of our customers don't know this, and even if they do, they don't have the foresight to hold on to their losing tickets in order to verify their deductions. Indeed, whoever really expects to win over $1,000 at odds of 300 to 1 or better?

I dare say, Mr. Chairman, that if you or any of your colleagues go up to Pimlico or to Laurel, you throw away your losing tickets if your horse does not win—everybody does. The point is that our bettors are losers over the course of a year, but they don't have the documentation to establish that fact.

As Ronald Reagan wrote in 1980, just before being elected to the Presidency—and I quote directly—"The fellow who wins one day will probably lose it back the next. Few bettors wind up ahead at the end of the year." So when they do win, and we withhold 20 percent of the payout, there is no practical way for them to recover the money withheld.

There have been more than 85,000 instances of withholding in connection with off-track betting operations since 1976. As I have said, withholding is resented, and the resentment causes a desire to avoid withholding. Avoidance is simple: the customer just goes to the bookmaker. The Federal tax policy toward legal payouts generally encourages illegal gambling.

As we have learned this afternoon, Canada, Great Britain, France, Ireland, Australia, none of these countries tax legal payouts. We do so tax legal payouts in the United States, and in the United States alone. This is one of the main reasons why millions of otherwise law-abiding Americans gamble illegally when legal betting services of one form or another have been authorized by a majority of the States. This illegal gambling revenue, or at least much of it, goes into the coffers of organized crime.

Withholding has made a bad tax policy worse. Every time a lucky bettor has a portion of his payout withheld, a perception is created, that perception is, in the mind of the bettor, "If you bet at OTB or at the racetrack, the Government will take part of your winnings."

Multiply this by the large number of instances of withholding, and the result is a widely perceived competitive disadvantage for OTB and the tracks. "The bookmaker doesn't withhold. The bookmaker doesn't report my winnings to IRS. The bookmaker doesn't hassle me with regulations, and with regulations that I really don't understand." Perceptions such as these are notoriously difficult to combat.

An analysis of withholding discloses that it produces somewhere between $3 million and $22 million in revenues to the Federal Government. It is just a drop in the bucket, really. This is further reduced by the decreases in State and local government gambling revenue caused by withholding.

Withholding has drained substantial amounts of money from the parimutuel industry's cash flow. Because of withholding everybody in the parimutuel industry has their net income reduced.

As the Assistant Secretary of the Treasury was honest enough to testify this morning before your distinguished group—and I quote from him directly—"Withholding is not a major revenue loss." That is a direct quote from him this morning.

I ask the subcommittee to note further that withholding was imposed over the objection of the Federal Commission on Gambling. After an exhaustive study of the issue, the Commission, in its report in 1976, recommended against withholding for the specific reasons that it would encourage illegal gambling and reduce State parimutuel revenues. The report further observed that withholding constituted a counterproductive Federal interference in an area traditionally reserved to the States.

I thank you for your attention.

[The prepared statement follows:]

STATEMENT OF JOHN F. KEENAN, PRESIDENT AND CHAIRMAN OF THE BOARD OF DIRECTORS, NEW YORK CITY OFF-TRACK BETTING CORPORATION, ON BEHALF OF THE NATIONAL ASSOCIATION OF OFF-TRACK BETTING

Mr. Chairman, Members Of The Subcommittee:

It is a distinct privilege to submit this paper to you today on behalf of the governmental off-track betting services of New York and Connecticut, and to review with you OTB'S experience with withholding from legal pari-mutuel payouts and the reasons for OTB'S support of H.R. 4592, the legislation introduced by Mr. Holland to repeal this withholding and make the tax treatment of pari-mutuel payouts somewhat more equitable.

OTB exists for government. In New York and Connecticut legal, non-profit off-track betting facilities are operated solely for the public benefit to accommodate the large numbers of people who prior to the advent of OTB were betting off-track illegally with bookmakers. Off-track betting was authorized by these two States, after extensive public debate and, in New York City, following an overwhelmingly favorable referendum, for the purposes of raising State and municipal government revenues and curbing illegal gambling by providing bettors with a competitive legal alternative. Essentially OTB represents an imaginative initiative by these States to fund government and reduce the massive illegal gambling that afflicts society by diverting off-track wagers from criminal channels and directing this revenue to constructive use.

In both New York and Connecticut OTB has proven to be a successful revenue-raising measure. Since 1971, when New York City's Off-Track Betting Corporation, which was the first OTB operation to be organized, began accepting wagers, OTB has generated more than $1 billion for governments in these States. The revenue OTB generates is very important to our governments, especially at the municipal and local level where these revenues help defray the costs of essential government services.

In addition to public funds OTB has contributed more than $500 million to the racing industry. In New York, racing is a major employer and an important source of revenue for State government. Overall, on a current basis OTB distributes approximately $246 million a year, $161 million of this amount to government and the remaining $85 million to the racing industry.

The basic reason we support H.R. 4592 is that withholding from legal pari-mutuel payouts has reduced OTB'S ability to accomplish its statutory purposes.

Withholding is deeply resented by our bettors. Under the law taxpayers are allowed to deduct losses, if they file an itemized return, to the extent of their winnings. Despite our best efforts to inform our customers of their right to do this many of them do not understand, and many more take the standard deduction and consequently are able to receive no credit for their losses at all. For those of you who are unfamiliar with horse race betting, let me assure you that virtually all bettors, regardless of their wins on any one day, are losers over the course of a year. The pari-mutuel system, which at OTB removes from each pool an average of 23% for government and the racing industry and to cover the operator's expenses, ensures that over time most bettors must lose.

Our bettors know this. They bet for recreation, as a pastime, not to get rich. When they do win, and we withhold 20% of their payout, they have, as I have explained, no practical way of recovering the money withheld by receiving the credit for their losses to which the law theoretically entitles them. In these cases they think the government is being very unfair. More than 85,000 instances of withholding have occurred in our operations since 1977, and as a result this resentment is widespread. There is an equally widespread desire to avoid withholding. The way to avoid withholding is to go to a bookmaker.

The Federal tax treatment of legal payouts generally encourages illegal gambling. Great Britain, France, Ireland, Australia - none of these countries tax legal payouts. We do so tax in the United States and this is an important reason for millions of otherwise law-abiding Americans gambling illegally when legal betting services of one form or another have been authorized by a majority of the States. This illegal gambling revenue, or at least much of it, goes into the coffers of organized crime.

Withholding has made a bad tax policy worse. Every time a "lucky" bettor has a portion of his payout withheld a perception is created. That perception is if you bet at OTB the government will take part of your winnings. Multiply this by the large number of instances of withholding and the result is a widely perceived competitive disadvantage for OTB: "the bookmaker doesn't withhold; the bookmaker doesn't report my winnings to IRS; the bookmaker doesn't hassle me with regulations I don't understand". Perceptions such as these are notoriously difficult to combat. In the final analysis when withholding is legislated a competitive advantage for illegal bookmakers is created that legal off-track betting services are powerless to overcome. In imposing the requirement to withhold, the Federal Government has frustrated our States' attempt to provide a competitive legal alternative to illegal bookmakers, and has thereby impaired OTB's ability to generate revenue for our States and municipalities.

My understanding is that IRS has estimated that withholding yields tax collections of $100 million a year. I'm a lawyer, not an economist, but we have had several qualified persons, including an economist and a former IRS staff member with expertise in this area, examine this $100 million figure. It appears to represent the gross money withheld from bettors.

IRS itself admits that some of this money is withheld from persons with no tax liability or who were not required to file a tax return. IRS is of course obliged to return these withholdings to the bettors. In addition, we had an independent study made of New York OTB bettors who had a portion of their payouts withheld, and nearly a third of them were due a partial refund of their withholdings. Altogether these full and partial refunds amount to $32 million, leaving $68 million, not $100 million, in actual tax receipts from legal betting.

Withholding wasn't necessary to produce all of this $68 million in tax receipts. Many people report income, including income from legal betting, voluntarily. From statistics supplied by IRS (in table 6 of the IRS Study of Compliance in Reporting Gambling Winnings) it appears that 87% of bettors who have part of their payout withheld do report their income from betting. Further, it appears from the same IRS statistics that in the worst case, even without withholding, 68% of bettors would continue to report these payouts. Without withholding, therefore, bettors would voluntarily report $46 million to $59 million of the $68 million in betting income tax receipts presently being withheld. In other words, withholding is producing as little as $9 million, and not more than $22 million, in revenue for the Federal Government.

A fair analysis requires these amounts to be further reduced by the decreases in State and local government gambling revenue caused by withholding. As demonstrated above, withholding has stimulated illegal gambling at the expense of State-authorized legal gambling operations. More directly, withholding has drained substantial amounts of money from the pari-mutuel industry's cash flow.

In October 1980 President Ronald Reagan wrote:

> "A withholding tax on wagers is detrimental to the industry. This takes out of circulation, immediately, funds which are 'rolled over' during each night's wagering. (Withholding) sets up another administration burden on the tracks. The IRS will have to hire more people not only to collect the money, but to send it back to the public, because it has been my observation that the fellow who wins one day will probably lose it back the next. Few bettors wind up ahead at the end of the year. Withholding earnings at the race tracks is just another way for the bureaucrats to enlarge their empire."

Each dollar wagered at a pari-mutuel facility is rewagered an average of three and a half times. This is due to the return to patrons of an average 80% of wagering pools and the subsequent rebetting, or "churning", of those same dollars through the pari-mutuel machines. Every dollar withheld from the betting stream therefore translates into a $3.50 reduction in overall wagering, or "handle". The $65.9 million withheld from pari-mutuel bettors in 1977 thus translates into $231 million in reduced wagering nationwide. Assuming a 20% takeout from pari-mutuel pools the losses to those who share in pari-mutuel revenue were $46.2 million. Approximately one-third of this amount, or $15.4 million, would go to State and local government, including the governments in New York and Connecticut that benefit from OTB. An additional $5.9 million in Federal income tax receipts were lost because the companies and individuals who would have reported their share of this lost pari-mutuel revenue as income were unable to earn this money.

In other words, because of withholding everyone in the pari-mutuel industry has their net income reduced. As a result the Federal Government lost $5.9 million in income taxes. Deducting this $5.9 million from the $9 million, or $22 million, produced by withholding leaves just $3.1 million, or $16.1 million, as the adjusted, or spendable, Federal revenue yielded by the withholding system. This $3.1 million or $16.1 in Federal revenue must be set against the $15.4 million loss in State and local government pari-mutuel revenue which withholding has caused. The end result of the withholding system was, in the best case, to reduce overall government gambling revenue to less than $1 million. More probably withholding has produced a net loss for government of some $12 million.

I ask the Subcommittee to note further that withholding was imposed over the objection of the Federal Commission on Gambling. After an exhaustive study of the issue the Commission in its report in 1976 recommended against withholding for the specific reasons that it would encourage illegal gambling and reduce State pari-mutuel revenues. The report further observed that withholding constitutes a counterproductive Federal interference in an area traditionally reserved to the States and in fact guaranteed to the States by the Constitution.

Chairman **Stark**. Thank you very much, Mr. Keenan.

Our next witness is Mr. Barrie Brunet, president, Gaming Industry Association of Nevada, Inc., and of the MGM Grand Hotel in Reno.

Welcome to the committee, Mr. Brunet, and you may proceed in any way you see fit.

STATEMENT OF BARRIE BRUNET, PRESIDENT, GAMING INDUSTRY ASSOCIATION OF NEVADA, INC., AND PRESIDENT, MGM GRAND HOTEL, RENO, NEV.

Mr. **Brunet**. Thank you, Mr. Chairman.

My name is Barrie Brunet. I would like to summarize the first part of our testimony which addresses the role gaming has in the economy of Nevada.

It is almost impossible to overstate the importance of gaming to Nevada's economy. Gaming is the basis of that economy. It is not a small industry. Gaming and its associated hotel and tourist industries employ directly more than 109,000 people who earn more than $1.1 billion a year. Indirectly, gaming and its associated hotels and tourism provide jobs for an additional 130,000 Nevadans who earn $1.4 billion in salaries and wages.

Nevada is more economically dependent on tourism than any other State, and more than 80 percent of our tourism spending is directly attributable to the presence of gaming.

Gaming generates revenue which is already taxed by the State. In fiscal year 1980, this taxation yielded $148 million, or 51 percent of the State's revenue. Gaming related tourism generated an additional $120 million in State tax receipts, bringing the gaming industry's overall contribution to Nevada's government to $269 million, about 81 percent of all our State, county, and municipal government revenues.

My colleague, John Fitzgerald, will summarize the remainder of our testimony, which deals with the Federal tax treatment of gaming revenues.

[The prepared joint statement of Mr. Brunet and Mr. Fitzgerald follows:]

STATEMENTS OF BARRIE BRUNET, PRESIDENT, GAMING INDUSTRY ASSOCIATION OF NEVADA, INC., AND JOHN FITZGERALD, PRESIDENT, NEVADA RESORT ASSOCIATION

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE:

THE GAMING INDUSTRY ASSOCIATION OF NEVADA AND NEVADA RESORT ASSOCIATION, INC. REPRESENTS 60 PRIVATE OPERATORS LICENSED BY THE STATE OF NEVADA TO CONDUCT GAMING EITHER AS THE OPERATOR'S PRINCIPAL BUSINESS OR AS A SUPPLEMENT TO OTHER GOODS OR SERVICES. "GAMING" MEANS, IN NEVADA, GAMBLING AT TABLE OR CARD GAMES, SLOT MACHINES OR SIMILIAR DEVICES, OR ON THE OUTCOME OF SPORTS EVENTS OR HORSERACES WHERE THE PLAYER BETS AGAINST THE "HOUSE"- THE CASINO,- OR IN THE CASE OF SPORTS AND HORSERACE BETTING, AGAINST THE BOOKMAKER.

NEVADA GAMING IS PRIVATE ENTERPRISE. THE HOLDERS OF GAMING LICENSES ARE PRINCIPAL INVESTORS IN A GAMING BUSINESS OR KEY EMPLOYEES OF A GAMING BUSINESS - IN EITHER CASE, THE ASSETS OF THE BUSINESS DERIVE FROM INVESTED CAPITAL AND THE BUSINESS PROFITS OR LOSSES ARE THE RETURN ON THESE INVESTMENTS. MOST - (1,226) - OF THE LICENSEES IN NEVADA HOLD "RESTRICTED SLOT MACHINE" LICENSES, WHICH ALLOW THE HOLDER TO PLACE 15 OR FEWER SLOT MACHINES IN A NON-GAMING RETAIL ESTABLISHMENT, SUCH AS A BAR OR RESTAURANT. A MUCH SMALLER NUMBER HOLD LICENSES FOR "NONRESTRICTED SLOTS", MEANING 16 OR MORE SLOT MACHINES BUT NOT

TABLE GAMES. THE REMAINING 228, SOME OF WHOM ARE OUR MEMBERS, HOLD LICENSES FOR "NONRESTRICTED GAMES AND SLOTS", ENTITLING THE HOLDER TO OFFER THE FULL RANGE OF TABLE AND CARD GAMES AND SLOT MACHINES THE PUBLIC EXPECTS TO FIND IN A CASINO.

GAMING LICENSE HOLDERS INCLUDE BUSINESSES OF EVERY SIZE AND EVERY KIND, FROM SMALL "MOM-AND-POP" RESTAURANTS AND MOTELS TO LARGE,PUBLICLY TRADED CORPORATIONS. FOR SOME CORPORATE LICENSE HOLDERS, SUCH AS GOLDEN NUGGET OR SHOWBOAT, GAMING IS THE PRINCIPAL LINE OF BUSINESS. OTHERS, INCLUDING HILTON HOTELS, HOLIDAY INNS, SUMMA CORPORATION, DEL WEBB, AND RAMADA INNS, ARE DIVERSIFIED NATIONAL OR INTERNATIONAL CORPORATE ENTERPRISES THAT HAVE CHOSEN TO INVEST IN NEVADA'S GAMING INDUSTRY. ALL OUR LICENSE HOLDERS ARE VERY CLOSELY REGULATED BY THE STATE GAMING CONTROL BOARD AND GAMING COMMISSION: LICENSE HOLDERS WHOSE STOCK IS PUBLICLY TRADED ARE ADDITIONALLY REGULATED AT THE FEDERAL LEVEL BY THE SECURITIES EXCHANGE COMMISSION.

THE POINT WE ARE MAKING IS THAT NEVADA GAMING LICENSE-HOLDERS ARE DISTRIBUTED THROUGHOUT OUR STATE'S ECONOMY.

IN FACT, TO A CONSIDERABLE DEGREE, GAMING IS THE BASIS OF OUR ECONOMY, AND THROUGH PUBLICLY HELD SHARES IN LICENSED MULTI-STATE AND MULTI-NATIONAL CORPORATIONS THERE ARE "OWNERS" IN THE OTHER 49 STATES AS WELL. ALMOST CERTAINLY, EACH MEMBER OF THIS SUBCOMMITTEE HAS CONSTITUENTS WHO EITHER AS PRIVATE OR AS INSTITUTIONAL INVESTORS PARTICIPATE IN NEVADA'S GAMING INDUSTRY.

THIS IS NOT A SMALL INDUSTRY. GAMING AND ITS ASSOCIATED HOTEL AND TOURIST INDUSTRIES EMPLOY DIRECTLY MORE THAN 109,000 PEOPLE, ABOUT 27% OF NEVADA'S NON-AGRICULTURAL LABOR FORCE. THESE 109,00 EMPLOYEES EARN MORE THAN $1.1 BILLION A YEAR. INDIRECTLY GAMING AND ITS ASSOCIATED HOTELS AND TOURISM PROVIDE JOBS FOR AN ADDITIONAL 130,000 NEVADANS WHO EARN AN ADDITIONAL $1.4 BILLION IN SALARIES AND WAGES.

IT IS ALMOST IMPOSSIBLE TO OVERSTATE THE IMPORTANCE OF GAMING TO NEVADA'S ECONOMY. ALTHOUGH GEOGRAPHICALLY A LARGE STATE, MOST OF NEVADA IS DESERT OR ARID BASIN AND RANGE THAT HOWEVER BEAUTIFUL - AND FOR THOSE OF YOU WHO DO NOT KNOW OUR STATE WE INVITE YOU TO COME AND ENJOY OUR CLEAR SKIES AND WESTERN LANDSCAPES - OFFER LITTLE IN THE WAY OF NATURAL ECONOMIC OPPORTUNITY. MOREOVER, 87%

OF ALL NEVADA'S LAND IS OWNED BY THE FEDERAL GOVERNMENT, WHICH HAS FOR VARIOUS REASONS FORBIDDEN ANY ECONOMIC DEVELOPMENT OF ITS HOLDINGS. BY ITS ACTIONS AS OUR LANDLORD THE FEDERAL GOVERNMENT HAS THUS GREATLY REDUCED THE ALREADY LIMITED POSSIBILITIES FOR ECONOMIC ACTIVITY PROVIDED US BY NATURE.

MOST OF THE MONEY NEVADANS EARN IS BROUGHT INTO OUR STATE BY TOURISTS; IN FACT, NEVADA IS MORE ECONOMICALLY DEPENDENT ON TOURISM THAN ANY OTHER STATE. MORE THAN 80% OF OUR TOURIST SPENDING IS ATTRIBUTABLE TO THE PRESENCE OF GAMING. ANOTHER WAY TO PUT THIS IS THAT WITHOUT GAMING 60% OF OUR NON-AGRICULTURAL JOBS WOULD DISAPPEAR.

BESIDES JOBS AND ECONOMIC ACTIVITY, GAMING GENERATES REVENUE - TWO KINDS OF REVENUE, DEPENDING ON WHETHER THE HOUSE WINS OR LOSES.

WHEN THE HOUSE WINS THE RESULT IS GROSS GAMING REVENUE. THIS IS TAXED BY THE STATE OF NEVADA AND BY OTHER GOVERNMENTAL AGENCIES WITHIN THE STATE. IN FISCAL 1980 THIS DIRECT TAXATION OF NEVADA GAMING REVENUE YIELDED $178 MILLION, INCLUDING $148 MILLION FOR THE STATE OF NEVADA. $148 MILLION MAY NOT SOUND LIKE MUCH TO YOU HERE IN WASHINGTON, BUT IT WAS ABOUT 51% OF THE STATE'S REVENUES

THAT YEAR. GAMING-RELATED TOURISM GENERATED AN ADDITIONAL $120 MILLION IN STATE TAX RECEIPTS, BRINGING THE GAMING INDUSTRY'S OVERALL CONTRIBUTION TO NEVADA GOVERNMENT TO $269 MILLION, ABOUT 81% OF ALL OUR STATE, COUNTY, AND MUNICIPAL GOVERNMENT REVENUES. SCHOOLS, POLICE, SANITATION, ROADS - GAMING - GENERATED TAX RECEIPTS PAY 81% OF THE BILL FOR ALL THESE IN NEVADA.

THE FEDERAL GOVERNMENT ALSO SHARES IN THE HOUSE'S WIN. FEDERAL GAMING PRIVILEGE TAXES GENERATE A SMALL AMOUNT OF MONEY DIRECTLY, ABOUT $6.5 MILLION A YEAR. A MUCH LARGER SUM IS GENERATED FROM THE FEDERAL INCOME TAXATION OF THAT PORTION OF THE HOUSE WIN OUR INDUSTRY PAYS AS SALARY AND WAGES TO ITS EMPLOYEES, OR WHICH ENDS UP AS AFTER-EXPENSE PROFITS FOR OUR GAMING BUSINESSES. ALTOGETHER THE FEDERAL GOVERNMENT COLLECTS ABOUT $1.6 BILLION IN INCOME TAXES FROM COMPANIES OR INDIVIDUALS DEPENDENT UPON NEVADA GAMING AND GAMING-RELATED TOURISM.

EVEN HERE IN WASHINGTON THESE NUMBERS - $269 MILLION FOR NEVADA GOVERNMENT AND $1.6 BILLION FOR THE FEDERAL GOVERNMENT - SHOULD BE LARGE ENOUGH TO GIVE YOU SOME IDEA OF THE SUBSTANTIAL TAX REVENUES THAT ARE GENERATED EACH YEAR FROM NEVADA HOUSE WINS. WE THINK YOU CAN SEE THAT NEVADA GAMING IS A SIGNIFICANT TAX BASE FOR GOVERNMENT

AT ALL LEVELS. WE'RE LIKE ANY OTHER INDUSTRY, OF COURSE: WE DON'T ENJOY PAYING TAXES; MANY OF OUR MEMBERS THINK WE PAY MORE THAN OUR FAIR SHARE, AND WE HAVE ANOTHER SET OF REMARKS ON THIS SUBJECT IF ANY OF YOU WOULD LIKE TO HEAR THEM; BUT THE PRINCIPAL OF TAXING NET INCOME ARISING FROM GAMING REVENUES REALIZED WHEN THE HOUSE WINS IS ONE THAT WE ALL ACCEPT AND SUBSCRIBE TO. AS AN INDUSTRY WE'RE PROUD OF OUR FINANCIAL CONTRIBUTIONS TO GOVERNMENT.

AS WE SAID, GAMING GENERATES TWO KINDS OF REVENUE. WHEN THE HOUSE LOSES THE PLAYER WINS, AND THE QUESTION THEN ARISES: WHAT IS THE APPROPRIATE TAX TREATMENT OF THE PAYOUTS RECEIVED BY THE PLAYER?

UNDER EXISTING LAW THESE PAYOUTS ARE ADDED TO THE PLAYER'S TAXABLE ADJUSTED GROSS INCOME. THE PLAYER MAY, IF HE CLAIMS HIS LOSSES AS SEPARATELY ITEMIZED DEDUCTIONS AND IF HE CAN DOCUMENT HIS LOSSES TO THE SATISFACTION OF THE INTERNAL REVENUE SERVICE, RECEIVE TAX CREDIT FOR LOSSES TO THE EXTENT OF PAYOUTS IN ANY TAX YEAR.

AS SOME OF YOU PERHAPS KNOW, WINS AND LOSSES MAY SUCCEED ONE ANOTHER VERY RAPIDLY IN THE COURSE OF CASINO GAMING, AND AS A PRACTICAL MATTER EVERYONE, INCLUDING IRS, AGREES THAT FOR EITHER THE PLAYER OR THE HOUSE TO KEEP A RECORD OF THE OUTCOME OF EACH BET AT CRAPS OR TWENTY-ONE OR ROULETTE WOULD BE IMPOSSIBLE. CASINOS DO NOT ATTEMPT

TO KEEP SUCH RECORDS, EVEN FOR INTERNAL PURPOSES: CASINO ACCOUNTING RECORDS ONLY THE NET FLOW OF DOLLARS ACROSS, SAY, A CRAPS TABLE FOR A PERIOD OF TIME, USUALLY A WORKING SHIFT. IRS DOES REQUIRE CASINOS TO REPORT PAYOUTS AT KENO, BINGO, AND SLOT MACHINES DOWN TO A RELATIVELY LOW LEVEL. FOR EACH PAYOUT OF $1,200 OR MORE AT BINGO AND SLOT MACHINES AND $1,500 AT KENO AN INFORMATION RETURN, FORM W2-G, IS GENERATED BY THE HOUSE, WITH A COPY, OF COURSE, FOR THE PLAYER.

THE PRACTICAL RESULT OF TREATING LEGAL PAYOUTS IN THIS MANNER IS THAT A SMALL AMOUNT OF FEDERAL TAX - ABOUT $10 MILLION IN 1980 - IS COLLECTED AT VERY GREAT COSTS TO THE GAMING INDUSTRY AND THE ECONOMY OF NEVADA, NOT TO MENTION THE PLAYER AND EVEN THE FEDERAL GOVERNMENT.

LOOK AT THIS FROM THE PLAYER'S POINT OF VIEW: WHEN HE WINS HE HAS A TAX LIABILITY. WHEN HE WINS EVEN FAIRLY MODEST SUMS AT KENO, BINGO, OR SLOT MACHINES HIS PAYOUT IS REPORTED TO IRS. IN EITHER CASE, IN ORDER TO RECEIVE THE TAX CREDIT FOR HIS LOSSES THE LAW SAYS HE IS ENTITLED TO, HE MUST FIRST TRY TO DOCUMENT THOSE LOSSES ACCORDING TO THE CUMBERSOME AND INCONSISTENT STANDARDS APPLIED BY HIS IRS DISTRICT OFFICE, WHICH, EVEN IF HE IS AWARE OF THEM, HE ALMOST CERTAINLY WON'T BE ABLE TO MEET, AND THEN FORFEIT THE STANDARD DEDUCTION OR ZERO BRACKET AND FILE

AN ITEMIZED TAX RETURN. UNLESS HE IS WILLING AND CAN AFFORD TO HIRE A TAX ACCOUNTANT TO HELP HIM, HE WON'T, IN THE VAST MAJORITY OF CASES, BE ABLE TO DO THIS, AND WHAT HAPPENS IS THAT IRS TAKES PART OF HIS PAYOUT EVEN THOUGH IN ALL PROBABILITY THERE WAS NO NET INCOME REALIZED. MOREOVER - AND WE STRESS THIS - EVEN LARGE PAYOUTS ARE ONLY TEMPORARY GAINS. CASINOS STAY IN BUSINESS BECAUSE OF SOMETHING CALLED "THE HOUSE ADVANTAGE", OR "EDGE". THIS IS THE ARITHMETIC CERTAINTY THAT, OVER TIME, THE HOUSE WILL WIN. ALWAYS. THE PLAYER WHO "WINS" IS EXPERIENCING, IN REALITY, A VERY TEMPORARY STATISTICAL ANOMALY. IF HE CONTINUES TO PLAY - AND MOST PEOPLE DO CONTINUE TO PLAY - THE HOUSE ADVANTAGE WILL TAKE ITS TOLL AND HE WILL END UP WITH A NET LOSS.

PUT YOURSELF IN THE POSITION OF A PLAYER WHO GETS "LUCKY" AND WINS A SIZEABLE SLOT MACHINE PAYOUT LATE IN THE TAX YEAR. HE WAS ALMOST CERTAINLY A LOSER UNTIL HE HIT THE JACKPOT, SO, ALMOST CERTAINLY, HE HAS KEPT NO RECORDS OF HIS LOSSES. WHY SHOULD HE? LOSSES CAN ONLY BE CREDITED AGAINST WINNINGS, AND BEFORE HE HITS HIS JACKPOT, HE DIDN'T HAVE ANY WINNINGS. BUT NOW, IN NOVEMBER, HE WINS A LARGE PAYOUT. THE CASINO REPORTS HIS PAYOUT TO IRS. THE ACCUMULATED LOSSES OF A LIFETIME OF PLAY ARE, ALMOST CERTAINLY, MANY TIMES THE SIZE OF HIS PAYOUT, BUT THAT DOESN'T HELP HIM NOW. EVEN IF HE IS ABLE TO

DOCUMENT HIS LOSSES FOR THE REMAINDER OF THE YEAR THE END RESULT WILL BE A TAX BITE FROM HIS ONCE-IN-A-LIFETIME JACKPOT THAT HE CAN ONLY REGARD AS GROSSLY UNFAIR. AND SO THIS "LUCKY" PLAYER, WHO UNTIL HE "WON" WAS A SATISFIED PATRON OF A LEGAL GAMING ESTABLISHMENT, LEAVES THE CASINO WITH A JUSTIFIABLY SOUR TASTE IN HIS MOUTH - AND AN EXCELLENT REASON FOR SEEKING OUT AN ILLEGAL OPERATOR WHO WON'T REPORT HIS PAYOUTS TO IRS THE NEXT TIME HE WANTS TO GAMBLE. WE ARE NOT SUGGESTING THAT SLOT PLAYERS HAVE AN IDENTICAL ALTERNATIVE IN THE ILLEGAL SECTOR; HOWEVER, SPORTS AND HORSE BETTING AS WELL AS CARDS DO HAVE ILLEGAL ALTERNATIVES WHICH DEFINITELY HAVE A COMPETITIVE EDGE BECAUSE THERE IS NO WITHHOLDING OR REPORTING.

THE EXAMPLE WE'VE GIVEN IS NOT AN INFREQUENT OCCURRENCE. IN 1980 NEVADA'S GAMING INDUSTRY GENERATED 19,000 INFORMATION RETURNS OF PAYOUTS FOR KENO, BINGO, AND SLOT MACHINES. THE ADMINISTRATIVE COST TO THE INDUSTRY OF WRITING AND FILING AND REPORTING THESE RETURNS IS ESTIMATED AT $100 THOUSAND AS A MINIMUM COST TO THE OPERATOR.

THAT IS RELATIVELY MINOR, THOUGH, COMPARED TO THE COSTS TO NEVADA GOVERNMENT. THE EXISTING TAX TREATMENT OF LEGAL PAYOUTS HAS SIGNIFICANTLY REDUCED LEGAL PLAY. A STUDY BY A NATIONALLY KNOWN RESEARCH FIRM COMMISSIONED BY THE NEVADA GAMING INDUSTRY, WHICH WE SHALL BE HAPPY TO MAKE AVAILABLE TO THE SUBCOMMITTEE'S STAFF, ESTIMATED THAT AS A RESULT NEVADA'S ANNUAL GAMING REVENUE HAS BEEN REDUCED

BY $3.5 MILLION. THE CUMULATIVE EFFECTS OF CONTINUING THE EXISTING TAX TREATMENT OF LEGAL PAYOUTS FOR THE NEXT FIVE YEARS WOULD BE TO REDUCE OUR GAMING REVENUE BY $32 MILLION, WITH CONSEQUENT LOSSES OF 1,000 NEVADA GAMING INDUSTRY JOBS AND 2,200 ADDITIONAL JOBS IN GAMING-RELATED BUSINESSES ACCORDING TO THE STUDY.

FEDERAL TAX REVENUES HAVE ALSO BEEN ADVERSELY AFFECTED. THE REDUCTION IN THE GROWTH OF GAMING REVENUES CAUSED BY THE TAXATION OF LEGAL PAYOUTS WILL RESULT IN AN ANNUAL LOSS IN FEDERAL INCOME TAX REVENUES GENERATED BY GAMING AND TOURISM OF $21 MILLION BY 1987. THIS LOSS SIGNIFICANTLY EXCEEDS THE $7 MILLION TO $10 MILLION IRS ESTIMATE OF POTENTIAL INCOME FROM FULL COMPLIANCE WITH THE EXISTING FEDERAL TAXES ON LEGAL GAMING PAYOUTS.

WE WOULD LIKE HERE TO SAY A WORD ABOUT WITHHOLDING. THERE IS NOT CURRENTLY ANY WITHHOLDING FROM LEGAL GAMING PAYOUTS IN NEVADA, AND WE ARE THANKFUL FOR THAT. BUT WE HAVE VIEWED WITH ALARM THE ADVERSE EFFECTS OF WITHHOLDING FROM LEGAL PARI-MUTUEL PAYOUTS ON THE LEGAL PARI-MUTUEL INDUSTRIES OF OTHER STATES, WHICH RESEMBLE IN AGGRAVATED FORM OUR EXPERIENCE WITH UNNECESSARILY BURDENSOME REPORTING REQUIREMENTS. THE REGULATORY OFFICIALS OF 30 STATES AS WELL AS THE PARI-MUTUEL INDUSTRIES THEY REGULATE ARE AGREED THAT WITHHOLDING HAS REDUCED LEGAL BETTING AND STIMULATED ILLEGAL BOOKMAKING, WITH CONCOMMITANT LOSSES IN BOTH INDUSTRY AND GOVERNMENT PARI-MUTUEL REVENUE.

LET US BE CLEAR ABOUT THIS: WE REPRESENT AN ASSOCIATION OF LEGAL GAMBLING BUSINESSES THAT COMPRISE A MULTI-BILLION DOLLAR INDUSTRY. ILLEGAL GAMBLING IS OUR COMPETITOR. ILLEGAL OPERATORS TAKE PATRONS FROM US AND THEN USE THE ILLEGAL, UNTAXED REVENUES THEY GENERATE FROM OUR FORMER PATRONS TO TRY TO SUBVERT OUR INDUSTRY.

THIS STRIKES AT THE FOUNDATION OF THE CONTINUED EXISTENCE OF OUR INDUSTRY. ORGANIZED ILLEGAL GAMBLING PERSISTS IN THIS COUNTRY LARGELY BECAUSE THE EXISTING UNWISE TAX TREATMENT OF LEGAL PAYOUTS GIVES THE ILLEGAL OPERATOR AN "EDGE" - A PRICE ADVANTAGE, IF YOU WILL, THAT LEGAL OPERATORS CANNOT POSSIBLY OVERCOME. FOR THIS REASON THE REFORM OF THE LAWS GOVERNING THE TAX TREATMENT OF LEGAL PAYOUTS IS A MATTER OF VITAL CONCERN TO NEVADA'S GAMING INDUSTRY.

H.R. 4592 WOULD BE A SIGNIFICANT REFORM OF THE EXISTING LAW.

THE CARRYOVER OF LOSSES H.R. 4592 WOULD PROVIDE WOULD BRING THE PRACTICAL EFFECT OF THE LAW ON THE PLAYER MUCH CLOSER TO THE REALITY OF GAMBLING, WHICH IS, AS WE HAVE SAID, THAT OVER THE LONG TERM VIRTUALLY ALL GAMBLERS LOSE. THE URGENT NEED FOR THE REPEAL OF WITHHOLDING IS

EVIDENT FROM THE TESTIMONY GIVEN BY OTHER STATE AND PARI-MUTUEL INDUSTRY REPRESENTATIVES. BOTH OF THESE MEASURES, AS YOU HAVE HEARD FROM OTHERS TODAY, WERE ENDORSED BY THE FEDERAL GAMBLING COMMISSION AFTER THE MOST CAREFUL STUDY OF THE ISSUES INVOLVED.

THE $10,000 THRESHOLD FOR REPORTING PAYOUTS PRESENTLY REQUIRED TO BE REPORTED AT MUCH LOWER LEVELS WOULD ELIMINATE THE NEEDLESS REPORTING OF MODEST PAYOUTS THAT IN MOST CASES ENTAIL NO REAL TAX LIABILITY,WHILE ENSURING IRS KNOWLEDGE OF "WINDFALL" PAYOUTS THAT MAY PRODUCE NET GAMBLING GAINS.

Chairman **Stark**. Thank you, Mr. Brunet.

We are happy to welcome Mr. John Fitzgerald, who is president of the Nevada Resort Association, and managing director of the Las Vegas Hilton.

Mr. Fitzgerald, we are very happy to see you.

STATEMENT OF JOHN FITZGERALD, PRESIDENT, NEVADA RESORT ASSOCIATION, AND MANAGING DIRECTOR, LAS VEGAS HILTON, ACCOMPANIED BY JAMES E. RITCHIE, COUNSEL, GAMING INDUSTRY ASSOCIATION OF NEVADA, INC., NEVADA RESORT ASSOCIATION, AND NATIONAL ASSOCIATION OFF-TRACK BETTING, INC.

Mr. **Fitzgerald**. Thank you, Mr. Chairman.

Our formal statement outlines the flow of revenues in a casino operation. I would like to address the inequity or lack thereof in the present tax treatment of gaming payouts.

As you heard from Mr. Brunet's remarks, the house wins and pays taxes to the State and to the Federal Government. The question then arises, what is the appropriate tax treatment of the payouts received by the players.

We believe that our studies, which have been supplied to you, demonstrate that there is no tax basis for gaming transactions. This means that a player must include all his payouts in his taxable adjusted gross income. If the player itemizes his tax return, he may offset certain of his losses.

Those of you who have seen a casino know the rapid betting pattern of most customers. He cannot keep track of anything except his net figures. Mr. Holland's bill does not address this issue, which makes the present withholding an excise tax of 20 percent.

Nevada games do not have withholding, but we support repeal based upon the racing industry's experience. In 1980, Nevada's gaming industry's generated 19,000 information returns of payouts for keno, bingo, and slot machines. This reporting cost the industry

$100,000, this is relatively minor, though, compared to the cost to the Nevada government.

The existing tax treatment of legal payouts has significantly reduced legal play, reducing gaming revenue by $3.5 million which within the next 5 years will amount to $32 million and a loss of 1,000 jobs in gaming, and 2,200 additional gaming related jobs.

As far as the Federal revenue, it is estimated that it will be $21 million by 1987, which significantly exceeds the $7 or $10 million estimates repeal of withholding will cost.

We and the gaming industry are legal gaming, a multibillion-dollar industry. The present withholding requirements and other tax policies give the advantage to the illegal operators.

H.R. 4592 would be a significant reform of the existing law and we urge you to bring some equity to this legal industry.

Thank you, gentlemen.

[The following was submitted:]

H.R. 4592

POSITION PAPER

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March 16, 1982

NAOTB SUPPORTS H.R. 4592

The governmental off-track betting operations of New York and Connecticut support H.R. 4592, the legislation introduced by Mr. Holland to eliminate withholding from certain pari-mutuel payouts, require information returns only for payouts of $10,000 or more, and allow a three-year carryover of net losses from wagering transactions. Four years' experience with 20% withholding from legal pari-mutuel payouts imposed in the Tax Reduction and Simplification Act of 1977 has shown withholding to be a questionable tax policy that generates minimal net government taxes at the unacceptable costs of reducing State pari-mutuel revenue and increased illegal bookmaking.

By ending withholding H.R. 4592 would reduce Federal interference with the revenue-raising policies of thirty States by restoring the flow of State pari-mutuel revenue and enhance the States' ability to discourage illegal gambling by providing a competitive legal off-track betting service. The higher reporting threshold and carryover provisions of H.R. 4592 would bring a badly needed measure of equity to the Federal tax treatment of wagering transactions without impairing Federal wagering tax collections.

NAOTB IS GOVERNMENT

Off-track betting (OTB) is the extension of legal commercial horserace betting services to locations outside the racetrack grounds. OTB is not a wireroom. It is not illegal gambling and in New York and Connecticut it is not operated for private gain. In New York City an off-track betting referendum was overwhelmingly approved by the voters, and public benefit corporations were subsequently created by the State legislature and local legislative bodies to provide off-track betting services throughout New York State. In Connecticut a State agency established by the legislature conducts pari-mutuel off-track betting at sixteen separate locations and at a unique New Haven teletrack facility.

The National Association of Off-Track Betting (NAOTB) is the trade association of New York and Connecticut government off-track betting (OTB) operations that conduct legal pari-mutuel off-track betting for the purposes of raising government and racing industry revenue and reducing illegal gambling. OTB provides a significant and growing measure of State, municipal, and local tax relief in the form of off-track betting revenue that exceeded $161 million in 1980, an increase of 5.8% over 1979.

NAOTB membership includes six government regional off-track betting corporations in New York and the State off-track betting agency of Connecticut. Collectively these government operations employ 5,150 persons represented by eleven labor unions and contribute more than $150 million in jobs and direct spending to the economies of these States. OTB additionally generates $85 million for the racing industry, a major employer and an important source of revenue for State government, and has been effective in reducing illegal bookmaking on horseraces. OTB contributes directly to the economies of a number of States, including the States of Connecticut, Delaware, Florida, Illinois, Kentucky, Maryland, New York, and Pennsylvania, through interstate wagering conducted pursuant to contracts negotiated according to Federal guidelines established in the Interstate Horseracing Act of 1978.

THE FEDERAL GAMBLING COMMISSION RECOMMENDED THAT WITHHOLDING BE REPEALED

A Federal Commission charged by Congress with the comprehensive study of gambling recommended in its 1976 Final Report that the primary responsibility for gambling be reserved to the States as a matter of national policy. In the Interstate Horseracing Act of 1978 the 95th Congress adopted the Commission's recommendation, finding that "the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders".

In its review of Federal gambling taxes the Commission took note of the growing number of States that are attempting to raise revenue and reduce illegal gambling through governmental betting services. The Commission endorsed non-profit governmental off-track betting (OTB) for these purposes and found an overriding national interest in preventing Federal interference in the production of State gambling revenue.

The Commission condemned withholding from legal pari-mutuel payouts, concluding that such withholding

> "will increase the advantage of illegal operators, generate minimal revenues to the Government, and unnecessarily increase the administrative burden to the legal gambling businesses. The Commission recommends that Congress reexamine the probable impact of section 1207 (d) of the Tax Reform Act of 1976. If, upon reexamination, Congress finds the proposed withholding tax to be destructive of existing legal gambling industries, the Commission recommends that these withholding provisions be repealed."
>
> - Final Report of the Federal Commission on the Review of the National Policy Toward Gambling.

RONALD REAGAN HAS ALSO CONDEMNED WITHHOLDING

Closely paralleling the recommendations of the Federal Commission and the policy adopted by the 95th Congress Ronald Reagan has taken a firm position against Federal involvement in pari-mutuel racing and for racing as a matter reserved to the States:

> "We simply do not need the federal government in state-operated and state-controlled industries (such as pari-mutuel horseracing)"
>
> -Ronald Reagan, Hoof Beats Magazine October 1980.

Ronald Reagan condemns withholding from legal payouts as detrimental to the pari-mutuel racing industry and a merry-go-round of dollars:

> "A withholding tax on wagers is detrimental to the industry. This takes out of circulation, immediately, funds which are 'rolled over' during each night's wagering. (Withholding) sets up another administration burden on the tracks. The IRS will have to hire more people not only to collect the money, but to send it back to the public, because it has been my observation that the fellow who wins one day will probably lose it back the next. Few bettors wind up ahead at the end of the year. Withholding earnings at the race tracks is just another way for the bureaucrats to enlarge their empire"
>
> - Ronald Reagan, Hoof Beats Magazine and The Horsemen's Journal October 1980.

EXPERIENCE HAS CONFIRMED THE VIEWS OF RONALD REAGAN AND THE FEDERAL GAMBLING COMMISSION

Four years' experience with withholding from legal payouts has confirmed the 1976 warning of the Federal Gambling Commission and the recently expressed views of Ronald Reagan. The withholding imposed in the Tax Reduction and Simplification Act of 1977 has reduced legal OTB wagering and severely impaired OTB's ability to compete with illegal bookmakers.

A recent Internal Revenue Service study, Estimates of Income Unreported on Individual Income Tax Returns (IRS Publication 1104 (9-79), estimated that from $45.2 billion to $56.4 billion is wagered illegally in the United States annually, with $12.2 billion to $15.4 billion wagered in illegal games for which various States have sought to provide legal alternatives. Unreported income from illegal gambling is estimated by IRS at from $8.2 billion to $10.2 billion, with from $4.2 billion to $5.2 billion derived from illegal games that in various States are available in legal form. Assuming an effective tax rate of 30 percent, the annual revenue loss to the Treasury from illegal gambling ranges from $2.5 billion to $3.1 billion. Approximately half of this lost Federal tax revenue, $1.3

billion to $1.6 billion, is retained by operators of illegal games that various States have tried to eliminate by authorizing competing legal wagering services. These State anti-crime initiatives have been seriously impeded by withholding.

WITHHOLDING IS NOT A REVENUE ISSUE

The Federal tax treatment of legal payouts, and in particular the 20% withholding from certain payouts imposed in 1977, is the principal reason millions of otherwise law-abiding Americans gamble illegally when legal alternative wagering services are readily available. Tax collections from money withheld from legal payouts, estimated by IRS at $100 million annually, are far less than the Treasury's annual losses from unreported income derived from the illegal gambling that is stimulated by withholding.

Moreover, the $100 million IRS estimated was collected through withholding in 1977 is actually the gross amount withheld from bettors; this sum must be significantly reduced to arrive at an accurate statement of the net revenue yield to government. Over-withholding, including money withheld from persons not required to file or who had no tax liability, and excessive withholding from persons entitled to a partial refund of the 20% of their payout withheld amounted to $32 million, leaving $68 million in actual withholding tax receipts. Of this $68 million approximately $59 million was withheld from the 87 percent of taxpayers who voluntarily reported legal payouts, reducing the direct Federal revenue yield from the withholding system to $9 million. In other words, withholding produced only $9 million - and not $100 million - in revenue the Federal Government would not otherwise have received.

Even this $9 million in actual 1977 Federal tax receipts from the withholding system must be further reduced by the decreases in government gambling revenue caused by withholding. As noted, withholding has stimulated illegal gambling at the expense of State-authorized legal gambling operations. For the pari-mutuel industry alone the loss in legal wagering caused by withholding amounted to $231 million in 1977. Assuming a 20 percent takeout from pari-mutuel pools the losses to those who share in pari-mutuel revenue were $46.2 million. Approximately one-third of this amount, or $15.4 million, would go to State and local government. The remaining $30.8 million would become income for the groups comprising the pari-mutuel industry: racing associations, horsemen, jockeys, and so forth. Assuming conservatively that 50 percent of this $30.8 million was reported as profit or personal income and taxed at an average rate of 38 percent approximately $5.9 million in Federal income tax receipts would have been generated. This $5.9 million decrease in Federal income tax receipts must be deducted from the $9 million in 1977 Federal revenue produced by withholding, leaving only $3.1 million as the adjusted or net 1977 Federal revenue yield of the withholding system. Because this $3.1 million in Federal revenue must be set against the $15.4 loss in State and local government pari-mutuel revenue withholding caused the end result of the withholding system was to reduce overall government revenue by $12.3 million in 1977.

The foregoing statement of the actual effect of the withholding system is summarized in the following table:

	In Millions of Dollars	
Gross Monies Withheld in 1977		$100
Less Amounts Over-Withheld:		
(A) Withheld From Persons Not Required to File	($ 2.4)	
(B) Excess Withholding From Persons With		
(a) No Tax Liability		
(b) Partial Refund Due Taxpayer	($29.6)	($32)
=Adjusted Tax Collections From Withholding:		$68
Less:		
(C) Withheld From Taxpayers Who Complied Voluntarily:		($59)
=DIRECT REVENUE YIELD FROM WITHHOLDING SYSTEM:		$ 9
NEGATIVE IMPACT OF WITHHOLDING ON GOVERNMENT REVENUES		
(D) Decrease in Revenues Due to Decreased Cash Flow		
(a) To State and Local Governments	($15.4)	
(b) To Pari-mutuel Industry	($24.9)	
(c) To Federal Government	($ 5.9)	($ 5.9)
(E) Total direct Negative Impact	($46.2)	
ADJUSTED FEDERAL REVENUE YIELD ($9 Million Less $5.9 Million - See (D) (c))		$ 3.1

THE NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS HAS ASKED FOR WITHHOLDING'S REPEAL

The negative effects of withholding on legal off-track betting in New York and Connecticut have been felt by the on-track pari-mutuel racing industries of more than 30 States. The National Association of State Racing Commissioners (NASRC), the State officials responsible for the regulation of pari-mutuel racing and off-track betting, has condemned withholding as "extremely damaging to all segments of the pari-mutuel industry" and the cause of "considerable losses in direct pari-mutuel revenue to the States". At its 1981 convention the NASRC unanimously resolved to petition the Congress for the repeal of withholding.

WITHHOLDING AMOUNTS TO AN EXCISE TAX

Withholding does not accomplish the intent of Congress. Congress intended to ensure compliance with the tax laws by withholding a percentage of pari-mutuel payouts against a bettor's net gains from betting for the tax year. Under the law a bettor may deduct losses to the extent of payouts, and has a tax liability only on his net betting gains.

In practice withholding from legal payouts has proven to be an excise tax instead of a genuine withholding against net income from betting. Because all racetracks and OTB operations retain from fifteen to twenty-nine percent of all wagers as pari-mutuel revenue, few bettors have net gains over the course of the year. Yet, IRS standards for recording losses are so complex most OTB patrons cannot understand them, and are so cumbersome as to be for all practical purposes inconsistent with the activity of off-track betting. Moreover, very many OTB patrons take the standard deduction on their Federal tax return, and bettors cannot deduct even documented losses unless they give up the standard deduction and itemize their losses. In effect, withholding confiscates legal payouts from bettors who in most cases have no tax liability under the law, and who have no real opportunity to obtain tax credit for their losses from pari-mutuel off-track betting.

THE TAX [illegible]MENT OF LEGAL PAYOUTS DISCRIMINATES AGAINST OTB PATRONS

The adm[illegible]trati[illegible] [illegible]ent Federal tax law discriminates against patrons of legal off-track bet[illegible] se[illegible] [illegible]ike investors in securities, who are allowed to include only the net result of [illegible] [illegible]nd sales of securities in adjusted gross income, investors in pari-mutuel tick[illegible] [illegible] to include in adjusted gross income all gains from their investments in p[illegible] [illegible]s. Losses on investments in pari-mutuel pools must be claimed as [illegible]temi[illegible] [illegible]tions. The effect of this discriminatory tax treatment of pari-mutu[illegible] transactions is to artificially inflate the adjusted gross income of OTB bettors, [illegible]ardless of whether their losses - as is true for the overwhelming majority of bettors [illegible]n the course of a year - equal or exceed their gains. This artificially inflated adjusted gross income has in turn a number of unintended adverse tax consequences, including reduced medical contributions from taxpayers who bet at OTB.

While the law provides for the deduction of documented losses to the extent of winnings the standards for documenting losses are inconsistently applied by IRS and as a practical matter are impossible for the vast majority of OTB patrons to meet. Further, even if a bettor is able to document his losses to the satisfaction of IRS he is unable, under the present law, to declare them unless he gives up the standard deduction and itemizes his deductions. OTB patrons are overwhelmingly from middle and lower income brackets, and more than 49 % of W2-G recipients took the standard deduction on their 1978 Federal income tax return. The present tax treatment of legal payouts is also unfair in that while all payouts are taxed as income losses may be credited only to the extent of current year winnings. Bettors with documented losses exceeding current year winnings receive no tax credit for their 'excess' losses because they are unable to offset these losses against payouts in prior or subsequent years.

NAOTB URGES CONGRESS TO ENACT H.R. 4592

NAOTB joins the National Association of State Racing Commissioners, the American Horse Council, and legal wagering industries that generate annual revenues exceeding $2.3 billion for governments in 32 States in asking Congress to adopt the recommendation of the Federal Commission on the Review of the National Policy Toward Gambling and end withholding from legal payouts.

The repeal of subsection (q) of section 3402 of the Internal Revenue Code would substantially increase the flow of pari-mutuel revenue to the States and strengthen the horse and racing industries that are important sources of State revenues. By ending withholding Congress would significantly reduce Federal interference with State initatives to eliminate illegal gambling by authorizing legal alternative wagering services. The combined effect of these results would be to restore to the States their traditional responsibilities in the area of gambling policy.

The $10,000 threshold for information returns with respect to pari-mutuel payouts would ensure reporting of nearly all wagering transactions involving real tax liability while greatly reducing the present costs to governmental off-track betting services of administering the Internal Revenue Code. The effect of this provision would be to increase the revenues of the State, county, and municipal governments that receive the after-expense profits of governmental off-track betting services.

Finally, the three-year carryover and carryback of wagering losses H.R. 4592 would provide would enable taxpayers to receive the tax credit for such losses that was intended by Congress when section 165 (d) of the Internal Revenue Code was drafted. In view of the finding by the Federal Commission on Gambling that virtually all bettors sustain net losses over their betting careers the inability of bettors, under section 165 (d), to carry legal losses over to preceding or subsequent years is unfair, and needlessly encourages bettors to participate in illegal games. The carryover provision of H.R. 4592 would bring a badly needed measure of equity to the Federal tax treatment of legal wagering transactions.

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H.R. 4592

POSITION PAPER

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March 16, 1982

NEVADA AND ITS GAMING AND TOURIST INDUSTRIES SUPPORT H.R. 4592

The people of the State of Nevada through their elected representatives to the Congress and the State's private gaming and tourist industries through their trade associations support H.R. 4592, the legislation introduced by Mr. Holland to end withholding from certain payouts, require information returns only for payouts of $10,000 or more from wagering transactions presently required to be reported, and allow a three-year carryover of net losses from wagering transactions.

Under existing law all payouts are added to the player's adjusted gross income while losses may be deducted only to the extent of payouts in a given tax year, and then only if the player is able to document his losses to the Internal Revenue Service's satisfaction and claims them as separately itemized deductions. Moreover, gaming establishments are required to report payouts on bingo and slot machines of $1,200 or more and on keno of $1,500 or more to IRS, even though most players of these games have no practical way of obtaining the tax credit for their losses to which they are, under the law, theoretically entitled. The practical result of this unfair tax treatment of legal payouts has been to discourage legal play and stimulate illegal gambling, thereby reducing Nevada's annual State gaming revenue by $3.5 million and harming Nevada's multi-billion dollar private gaming industry. This reduction in the growth of Nevada gaming revenue will, if the present tax treatment of legal payouts is continued, reduce annual Federal income tax revenues from Nevada gaming and tourism by $21 million by 1987, a loss that far exceeds the $7 million to $10 million IRS estimate of potential Federal income from full compliance with Federal taxes on legal gaming payouts.

Withholding was imposed in 1976 over the objection of the Federal Commission on the Review of the National Policy Toward Gambling, which condemned the taxation of legal payouts as an unwarranted Federal infringement of State policy decisions to raise revenue, stimulate economic development, and aid law enforcement through legal gambling. The State of Nevada and its private gaming and tourist industries have viewed with alarm the adverse effects of withholding from legal payouts in 30 other States, which resemble the adverse effects of existing reporting requirements on Nevada legal gaming in aggravated form. Withholding has stimulated illegal gambling, thereby reducing essential State revenues and increasing substantially the burden of Federal, State, and local law enforcement. For these reasons both Ronald Reagan and the National Association of State Racing Commissioners, the State officials who regulate pari-mutuel betting in 30 States, have joined the Federal Gambling Commission in condemming withholding as a counter-productive tax policy.

The financial and economic contributions of the gaming and tourist industries to Nevada make the reform of existing Federal taxation of gambling a matter of overriding State concern. H.R. 4592 is a revenue neutral bill that would reverse the unintended adverse effects of withholding, increase State gambling revenues and significantly reduce Federal interference in an area traditionally left to the States. The higher reporting threshold and carryover provisions of H.R. 4592 are necessary tax reforms that would eliminate serious inequities in the existing Federal tax treatment of legal wagering transactions.

THE NEVADA GAMING INDUSTRY

The Nevada gaming industry comprises ninety-six companies, including twenty-five large (annual gaming revenue of $20 million and over) casino/hotel resorts, one hundred and five major casinos (annual gaming revenue of from $1 million to $19 million), 98 smaller casinos (annual gaming revenue of less than $1 million), sixty-two "casinos" that offer slot machines only, and 1,146 non-gaming retail establishments such as motels and restaurants that are licensed to operate a limited number of slot machines as a supplement to other retail goods or services. Twenty-one of the major casino/hotel resorts and many of the major casinos are owned by diversified publicly traded corporations, such as MGM, Holiday Inns, Caesars World, Inc., and Hilton Hotels Corporation, that operate Nevada casino/hotels as divisions of primarily non-gaming multi-State and international corporate enterprises. The remainder of Nevada's licensed gaming locations, many of them modest in size, are operated as small businesses by partnerships or individual entrepreneurs.

Direct State levies on Nevada gaming yield annual revenues of $148 million, or 51% of the State's revenues. In addition, Nevada gaming is subject to a variety of Federal, county, and municipal gaming privilege taxes. Altogether the Nevada gaming industry paid a total of $178 million in Federal, State, county, and municipal gaming taxes in FY 1980. Gaming-related tourism accounted for an additional $120 million, or 66%, of Nevada's 1980 non-gaming tax receipts, making the industry's overall contribution to Nevada government $269 million, or 81% of total State, county, and municipal government revenues.

In addition to various Federal gaming privilege taxes amounting to $6.5 million annually the Federal Government currently collects over $2.4 billion in income taxes from business operations in Nevada and from Nevada residents. Nearly $1.6 billion of this income tax revenue is derived from companies or individuals directly or indirectly dependent upon gaming and gaming-related tourism.

Nevada's economy has the highest tourism dependency of any State in the Union. With the inherently limited economic opportunities provided by an arid climate and a largely desert and mountainous terrain the State is heavily dependent on spending by non-resident firms and individuals, and tourism is the source of most of the gaming and non-gaming "foreign" spending that constitutes Nevada's basic income. More than 80% of Nevada's tourist spending is attributable to the presence of gaming.

Gaming and the associated hotel and tourist industries are Nevada's largest employers, providing jobs for 109,200 persons, or 27% of the State's non-agricultural labor force. Indirectly the gaming, hotel, and tourist industries employ an additional 129,900 Nevadans, bringing the total employment provided by these industries to 238,900 jobs, or 60% of the non-agricultural labor force. Salaries and wages paid by the gaming, hotel, and tourist industries amount to more than $1.1 billion. Direct non-personnel spending by these industries raises their overall annual contribution to Nevada's economy to more than $2.9 billion.

THE FEDERAL GAMBLING COMMISSION, THE 95th CONGRESS, AND RONALD REAGAN HAVE ALL ENDORSED A POLICY OF RESERVING GAMBLING TO THE STATES

The Federal Commission on the Review of the National Policy Toward Gambling recommended in its 1976 final report to Congress that the primary responsibility for gambling be reserved to the States as a matter of national policy. In the Interstate Horseracing Act of 1978 the 95th Congress adopted the Commission's recommendation, finding that "the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders". The Federal Commission's recommendation and the finding of the 95th Congress may be seen as consistent with the "new concept of Federalism" whereby President Reagan seeks to "restore balance to the Federal system" by returning to the States responsibilities for areas primarily of State concern together with tax sources commensurate with these responsibilities. Applying the principles of the New Federalism in this area, Ronald Reagan has taken a firm position against Federal involvement in government revenue-producing State gambling industries:

> "We simply do not need the federal government in state-operated and state-controlled industries (such as pari-mutuel horseracing)."

STATE INTERESTS AND POLICIES ARE SERVED BY NEVADA'S PRIVATE GAMING INDUSTRY

The State of Nevada legalized commercial gaming in 1931 in order to strengthen Nevada's economy and augment State revenues. After a thorough review of Nevada's gaming industry the Federal Gambling Commission concluded that the State has successfully realized its gambling policy goals, terming Nevada's legal casino gaming "an example of successful revenue-raising through legalized gambling" that had contributed materially to the State's fiscal soundness while providing (in 1976) more than 50% (now approximately 60%) of the State's jobs.

In making the choice to legalize commercial gaming Nevada adopted tax policies that serve the State's economic and revenue goals and accepted the responsibility of regulating its gaming industry in the public interest, allocating a substantial portion of the State's gaming revenue for this purpose. The Federal Commission carefully assessed Nevada's ability to exercise this responsibility in an effective manner and endorsed the State's regulation of gaming as "effective" and "the foundation upon which the gaming industry is built". The Commission found existing Federal, State, and local regulatory and law enforcement procedures functioning as an interlocking system of external controls that "make Nevada gaming the most closely scrutinized private industry in the country."

THE FEDERAL COMMISSION AND RONALD REAGAN HAVE CONDEMNED WITHHOLDING

In its Final Report the Federal Gambling Commission condemned withholding from legal payouts, concluding that such withholding

> "will increase the advantage of illegal operators, generate minimal revenues to the Government, and unnecessarily increase the administrative burden to the legal gambling businesses. The Commission recommends that Congress reexamine the probable impact of section 1207 (d) of the Tax Reform Act of 1976. If, upon reexamination, Congress finds the proposed withholding tax to be destructive of existing legal gambling industries, the Commission recommends that these withholding provisions be repealed."
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Closely paralleling the recommendations of the Federal Commission and the policy adopted by the 95th Congress, Ronald Reagan has taken a firm position against Federal involvement in State gambling industries and opposed withholding as a senseless merry-go-round of dollars:

> "A withholding tax on wagers is detrimental to the industry. This takes out of circulation, immediately, funds which are 'rolled over' during each night's wagering. (Withholding) sets up another administration burden on the tracks. The IRS will have to hire more people not only to collect the money, but to send it back to the public, because it has been my observation that the fellow who wins one day will probably lose it back the next. Few bettors wind up ahead at the end of the year. Withholding earnings at the race tracks is just another way for the bureaucrats to enlarge their empire".
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> - Ronald Reagan, Hoof Beats Magazine and The Horsemen's Journal October 1980.

EXPERIENCE HAS CONFIRMED THE PREDICTION OF THE FEDERAL COMMISSION AND THE VIEWS OF RONALD REAGAN

Four years' experience with withholding from legal payouts has confirmed the 1976 warning of the Federal Gambling Commission and the recently expressed views of Ronald Reagan. Withholding has reduced legal wagering and severely impaired the ability of legal gambling industries to compete with illegal operators.

Existing Federal tax policies, especially withholding and unreasonably low reporting thresholds, are important reasons why millions of otherwise law-abiding Americans gamble illegally when State-enabled legal alternatives are readily available. A recent Internal Revenue Service study, Estimates of Income Unreported on Individual Income Tax Returns (IRS Publication 1104 (9-79), estimated that from $45.2 billion to $56.4 billion is wagered illegally in the United States annually, with $12.2 billion to $15.4 billion wagered in illegal games for which various States have sought to provide legal alternatives. Unreported income from illegal gambling is estimated by IRS at from $8.2 billion to $10.2 billion, with from $4.2 billion to $5.2 billion derived from illegal games that in various States are available in legal form. Assuming an effective tax rate of 30 percent, the annual revenue loss to the Treasury from illegal gambling ranges from $2.5 billion to $3.1 billion. Approximately half of this amount, $1.3 billion to $1.6 billion, is retained by operators of illegal games that various States have tried to eliminate by authorizing competing legal wagering services. These State anti-crime initiatives have been seriously impeded by withholding and unnecessarily low reporting thresholds.

THE NATIONAL ASSOCIATION OF STATE RACING COMMISSIONERS HAS ASKED CONGRESS TO REPEAL WITHHOLDING

The negative effects of withholding have been felt by the on-track and off-track pari-mutuel industries of more than 30 States. The National Association of State Racing Commissioners (NASRC), the State officials responsible for the regulation of pari-mutuel racing and off-track betting, has condemned withholding as "extremely damaging to all segments of the pari-mutuel industry" and the cause of "considerable losses in direct pari-mutuel revenue to the States". At its 1981 convention the NASRC unanimously resolved to petition the Congress for the repeal of withholding.

UNNECESSARILY BURDENSOME REPORTING REQUIREMENTS HAVE DAMAGED NEVADA'S GAMING INDUSTRY

In aggravated form the adverse effects of withholding on legal gambling in other States resemble the adverse effects of existing Federal tax policy on the State of Nevada and its private gaming industry. In particular, the taxation of legal gaming payouts as income and the attempt to ensure player compliance with this tax policy through unnecessarily burdensome reporting requirements have seriously damaged Nevada gaming.

A 1978 independent study of more than 750 Nevada gaming winners subject to reporting (on IRS Form W2-G) requirements by a nationally known consulting firm has shown that numbers of players have stopped playing entirely because of Federal taxation of legal payouts, while other players have reduced play or switched to illegal games. The average reduction in legal play for the winners studied is 15%. This reduction in legal play has had significant adverse effects upon the Nevada economy, State tax revenues, and tax revenues to the Federal Government.

Nevada's annual gaming revenue has been reduced by $3.5 million. Because this reduction is cumulative while existing Federal tax policy remains in force the resulting annual reduction in the growth of Nevada gaming revenue will increase to $32 million by 1987, and continue to grow thereafter. This reduction in gaming revenue has seriously affected Nevada's economy and reduced State and local tax revenues. By 1987 the reduction in gaming revenue growth will, if the taxation of legal payouts is continued, eliminate 1,000 Nevada gaming industry jobs and 2,200 jobs in gaming-related industries. There would be a direct loss of $10 million in salaries, and an overall loss to the Nevada economy of $39 million. State and local tax revenues would be reduced by $3.3 million annually, with the cumulative tax loss to Nevada government amounting to $30 million by 1987.

Federal tax revenues have also been adversely affected. The reduction in the growth of gaming revenues caused by the taxation of legal payouts will result in an annual loss in Federal income tax revenues generated by gaming and tourism of $21 million by 1987. This loss significantly exceeds the $7 million to $10 million IRS estimate of potential income from full compliance with Federal taxes on legal gaming payouts.

THE EXISTING TAX TREATMENT OF LEGAL PAYOUTS DISCRIMINATES AGAINST PATRONS OF NEVADA'S PRIVATE GAMING INDUSTRY

Existing Federal tax law discriminates unfairly against patrons of Nevada's legal gaming establishments, who must prove both their payouts and their losses to ensure they are not unfairly taxed. While gaming establishments are frequently required to report payouts at keno, bingo, and slot machines IRS standards for recording losses are so complex many players cannot understand them, and are so cumbersome as to be for all practical purposes inconsistant with the activity of gaming. Moreover, even if a player is able to document his losses to the satisfaction of IRS he is unable, under the present law, to receive credit for losses that exceed current year payouts even though the vast majority of players are net losers over the long term. The impractical nature and general unfairness of the existing tax treatment of legal payouts was recognized by the Federal Commission, which concluded that the law and its administration by IRS encouraged illegal gambling:

> "(t)he requirement that a player be able to prove both his winnings and his losses is not one that can be realistically met by the gambler, particularly with respect to casino gambling....It is generally accepted that few bettors are net winners during a given year or, for that matter, during their gambling careers; most bettors sustain a net loss (emphasis added). Those who have a winning year, and properly declare their winnings, are not permitted to carry back or carry forward losses from previous or subsequent years as a deduction from other income. This encourages patronage of illegal games..."

THE STATE OF NEVADA AND ITS PRIVATE GAMING AND TOURIST INDUSTRIES URGE CONGRESS TO ENACT H.R. 4592

The State of Nevada and its principal industries urge the Congress to adopt the recommendation of the Federal Commission on the Review of the National Policy Toward Gambling and end withholding from legal payouts.

The repeal of subsection (q) of section 3402 of the Internal Revenue Code would substantially increase the flow of gambling revenue to the States and strengthen legal gambling industries that are important sources of State revenues. By ending withholding Congress would significantly reduce Federal interference with State initiatives to eliminate illegal gambling by authorizing legal alternative wagering services. The combined effect of these results would be to restore to the States their traditional responsibilities in the area of gambling policy.

The $10,000 threshold for information returns for legal payouts from wagering transactions presently required to be reported would ensure reporting of nearly all wagering transactions involving real tax liability while greatly reducing the present costs to legal gambling industries of administering the Internal Revenue Code. The effect of this provision would be to increase the revenues of the State, county, and municipal governments that derive essential revenues from legal gambling.

Finally, the three-year carryover of wagering losses H.R. 4592 would provide would enable taxpayers to receive the tax credit for such losses that was intended by Congress when section 165 (d) of the Internal Revenue Code was drafted. In view of the finding by the Federal Commission on Gambling that virtually all players sustain net losses over their gambling careers the inability of taxpayers, under section 165 (d), to carry legal losses over to preceding or subsequent years is unfair, and needlessly encourages players to gamble illegally. The carryover provision of H.R. 4592 would bring a badly needed measure of equity to the Federal tax treatment of legal wagering transactions.

"IS FEDERAL TAX KILLING RACING?" -- Philadelphia Daily News, 1977 .... "GOOD SENSE WAS WITHHELD FROM SOMEBODY ON THE HILL" -- Washington Post, 1978 ... "SCHEMING FOR MORE TAX $$: IRS PLAN ZAPS BETTORS" -- New York Post, 1982 .... "ALL BETS OFF WITH WITHHOLDING TAX" -- Washington Star, 1976 ... "ANOTHER FEDERAL GRAB" -- Manchester (N.H.) Union Leader, 1976 .... "WITHHOLDING FLIMFLAM" -- Wall Street Journal, 1982

THE WITHHOLDING INJUSTICE

A Statement In Support Of
Repeal Of Withholding

Presented to the
Subcommittee on Select Revenue Measures
House Ways and Means Committee
Hearings on H.R. 4592
March 16, 1982

"FEDERAL LAWS FAVOR ILLEGAL BETTING" -- New York Times, 1978 .... "20% WITHHOLDING TAX THE BLIGHT OF HORSE RACING" -- Lexington Herald, 1978 .... "INFLATION STAGGERS RACE TRACKS, TAXES FINISHING THEM OFF" -- Washington Post, 1976 .... "BETS PAY OFF FOR IRS ONLY" -- Baltimore Sun, 1977 .... "HORSEPLAYERS AT A LOSS FOR JUSTICE" -- Washington Post, 1979 .... "RACING'S NEGATIVE INCOME TAX" -- Chicago Tribune, 1978

END WITHHOLDING FROM LEGAL PAYOUTS

Withholding from legal payouts is not a revenue issue. It is a States' Rights issue, one vitally affecting the decision of a majority of the States to authorize some form of commercial gambling in order to raise government revenues, realize economic development goals, and reduce illegal gambling that generates money for organized crime. State-authorized gambling produces more than $2.3 billion for State and local government annually. These revenues are used to fund the costs of essential services that, because of Federal austerity and the Administration's New Federalism policies, are increasingly being turned back to the States. The Federal Commission on the Review of the National Policy Toward Gambling opposed withholding on the grounds that it would stimulate illegal gambling and reduce State gambling revenues, and the States through the National Association of State Racing Commissioners have called upon Congress to end withholding from legal payouts.

H.R. 4592/S. 1861 is legislation that would significantly increase State gambling revenues and reduce illegal gambling without adversely affecting Federal tax collections. By ending withholding from legal payouts H.R. 4592/S. 1861 would remove a major Federal impediment to the States' ability to implement publicly approved gambling policies. The higher threshold for reporting legal payouts of H.R 4592/S. 1861 would ensure reporting of nearly all wagering transactions involving real tax liability, while greatly reducing for State-authorized gambling operations the present costs of administering the Internal Revenue Code. Finally, the three-year carryover of wagering losses provided for in H.R. 4592/S. 1861 would enable taxpayers to receive the tax credit for such losses that was intended by Congress when section 165 (d) of the Internal Revenue Code was drafted.

H.R. 4592/S.1861

The organizations listed at the end of this document, comprising horse interests of all States, the pari-mutuel horse racing industries of twenty-nine States, the governmental off-track betting operations of New York and Connecticut, fifteen State lotteries, the pari-mutuel jai-alai industries of Connecticut, Rhode Island and Florida, the pari-mutuel greyhound racing industry, and the private gaming and tourist industries of Nevada and New Jersey support H.R. 4592 and S.1861, the legislation introduced by Mr. Holland and Senators Laxalt and Cannon to end withholding from certain payouts, require information returns only for payouts of $10,000 or more from wagering transactions presently required to be reported, and allow a three-year carryover of net losses from wagering transactions.

BACKGROUND

Withholding of 20% from payouts of more than $1,000 at odds of at least 300 to 1 from pari-mutuel horse racing, greyhound racing, and jai-alai and payouts of more than $5,000 from State lotteries was imposed on May 18, 1977 pursuant to section 3402 (q) of the Internal Revenue Code added by section 1207 (d) of the Tax Reform Act of 1976. A previous requirement for parimutuel operations and State lotteries to report payouts of more than $600 at odds of at least 300 to 1 was continued, and effective May 1, 1977, the Internal Revenue Service required bingo and slot machine payouts of $1,200 and keno payouts of $1,500 to be reported pursuant to the Conference agreement on the Tax Reform Act. Withholding and the reporting requirements were imposed following Treasury Department and Internal Revenue Service determinations that these measures would ensure compliance with the Internal Revenue Code and yield significant and previously uncollected Federal tax revenues.

ISSUE: GAMBLING IS AN AREA OF STATES' RIGHTS AND STATE RESPONSIBILITY

Gambling has traditionally been an area reserved to the States. Since the 1930s, and increasingly in the past two decades, a majority of the States have authorized some form of commercial gambling to raise revenue for State and municipal government, encourage horse breeding, stimulate economic activity generally, encourage the development of economically depressed areas, and reduce illegal gambling by providing competitive legal alternatives.

In general, these State initiatives have been successful. State, county and municipal governments currently derive approximately $2.3 billion annually from the direct taxation of State-authorized commercial gambling. Pari-mutuel horserace betting, which twenty-nine States either conduct directly as a governmental function or regulate as a State-franchised private industry, contributes nearly $1 billion a year in government revenues and is the principal support of the enormous American horse agribusiness, which makes an annual contribution to the national economy conservatively estimated at $10 billion. State lotteries generate approximately $1.2 billion annually, either for State general funds or, in four of the fifteen States that conduct lotteries, for aid to education.

The State of Nevada derives approximately $270 million, or 81% of its State, county, and municipal government revenues, from the taxation of gaming and gaming-related tourism, which provide jobs for 27% of Nevada's non-agricultural labor force and contribute more than $2.9 billion to the State's economy each year.

State-authorized commercial gambling also contributes billions of dollars to the Federal Treasury through the income taxation of companies and individuals engaged in or dependent on the gambling industry. For example, the Federal Government collects approximately $1.6 billion a year in income tax revenue from companies and individuals directly or indirectly dependent on Nevada's gaming and gaming-related tourist industries.

State initiatives authorizing commerical gambling for publicly approved purposes have made Federal involvement in this area, and especially the Federal tax treatment of legal payouts, matters of growing State concern. These questions have received recent Federal attention in the form of a Federal Commission on the Review of the National Policy Toward Gambling, which recommended in its 1976 final report to Congress that the primary responsibility for gambling be reserved to the States as a matter of national policy. In the Interstate Horseracing Act of 1978, the 95th Congress adopted the Commission's recommendation, finding that "the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders".

THE EXISTING FEDERAL TAX TREATMENT OF LEGAL PAYOUTS INTERFERES WITH STATE GAMBLING POLICIES

Section 1207(d) was enacted over the objection of the Federal Commission on the Review of the National Policy Toward Gambling, which condemned withholding as an unwarranted Federal infringement of State policy decisions to raise revenue, stimulate economic development, and aid law enforcement through legal gambling. In its Final Report the Federal Commission predicted that withholding

> "will increase the advantage of illegal operators, generate minimal revenues to the Government, and unnecessarily increase the administrative burden to the legal gambling businesses. The Commission recommends that Congress reexamine the probable impact of section 1207 (d) of the Tax Reform Act of 1976. If, upon reexamination, Congress finds the proposed withholding tax to be destructive of existing legal gambling industries, the Commission recommends that these withholding provisions be repealed."

Four years' experience with withholding from legal payouts has confirmed the 1976 warning of the Federal Gambling Commission. Withholding has severely limited the ability of State-authorized gambling businesses to compete with illegal operators. Independent studies have shown reductions in legal wagering of as much as 15% due to withholding, with corresponding reductions in State gambling revenues. Withholding, and the existing Federal tax treatment of legal payouts generally, are important reasons why millions of otherwise law-abiding Americans gamble illegally when State-authorized legal alternatives are readily available. A recent Internal Revenue Service study, Estimates of Income Unreported on Individual Income Tax Returns (IRS Publication 1104 (9-79), estimated that each year from $12.2 billion to $15.4 billion is wagered in illegal games for which various States have sought to provide legal alternatives.

WITHHOLDING HAS BEEN CONDEMNED BY THE STATES AND BY RONALD REAGAN

The negative effects of withholding have caused the National Association of State Racing Commissioners (NASRC), the State officials responsible for the regulation of pari-mutuel racing, off-track betting and jai-alai, to condemn withholding as "extremely damaging to all segments of the pari-mutuel industry" and the cause of "considerable losses in direct pari-mutuel revenue to the States." At its 1981 convention the NASRC unanimously resolved to petition the Congress for the repeal of withholding.

Ronald Reagan, applying the principles of the New Federalism in this area, has similarly taken a firm position against Federal interference in State-authorized commercial gambling and opposed withholding as a senseless merry-go-round of dollars:

> "We simply do not need the federal government in state-operated and state-controlled industries (such as pari-mutuel horseracing)."
>
> "A withholding tax on wagers is detrimental to the industry. This takes out of circulation, immediately, funds which are 'rolled over' during each night's wagering. (Withholding) sets up another administration burden on the tracks. The IRS will have to hire more people not only to collect the money, but to send it back to the public, because it has been my observation that the fellow who wins one day will probably lose it back the next. Few bettors wind up ahead at the end of the year. Withholding earnings at the race tracks is just another way for the bureaucrats to enlarge their empire."

WITHHOLDING IS NOT A REVENUE ISSUE

Withholding has proven to be an ineffective revenue producer. Tax collections from money withheld from legal payouts, estimated by IRS at $100 million annually, are far less than the Treasury's annual losses from unreported income derived from the illegal gambling that is stimulated by withholding. According to IRS, each year from $4.2 billion to $5.2 billion is retained by operators of illegal games that various States have tried to eliminate by authorizing competing legal wagering services. Assuming an effective tax rate of 30 percent, the annual revenue loss to the Treasury from this unreported income from illegal gambling is $1.3 billion to $1.6 billion a year.

Moreover, the $100 million IRS estimated was collected through withholding in 1977 is actually the gross amount withheld from bettors; this sum must be significantly reduced to arrive at an accurate statement of the net revenue yield to government. Over-withholding, including money withheld from persons not required to file or who had no tax liability, and excessive withholding from persons entitled to a partial refund of the 20% of their payout withheld amounted to $32 million, leaving $68 million in actual withholding tax receipts. Of this $68 million approximately $59 million was withheld from the 87 percent of taxpayers who would have voluntarily reported legal payouts, reducing the direct Federal revenue yield from the withholding system to $9 million.

In other words, withholding produced only $9 million - and not $100 million - in revenue the Federal Government would not otherwise have received.

Even this $9 million in actual 1977 Federal tax receipts from the withholding system must be further reduced by the decreases in government gambling revenue caused by withholding. As noted, withholding has stimulated illegal gambling at the expense of State-authorized legal gambling operations. For the pari-mutuel industry alone the decrease in legal wagering caused by withholding amounted to $231 million in 1977. Assuming a 20 percent takeout from pari-mutuel pools the losses to those who share in pari-mutuel revenue were $46.2 million. Approximately one-third of this amount, or $15.4 million, would go to State and local government. The remaining $30.8 million would become income for the groups comprising the pari-mutuel industry: racing associations, horsemen, jockeys, and so forth. Assuming conservatively that 50 percent of this $30.8 million would have been reported as corporate profit or personal income and taxed at an average rate of 38 percent, approximately $5.9 million in Federal income tax receipts would have been generated. This $5.9 million decrease in Federal income tax receipts must be deducted from the $9 million in 1977 Federal revenue produced by withholding, leaving only $3.1 million as the adjusted or net 1977 Federal revenue yield of the withholding system.

Because this $3.1 million in Federal revenue must be set against the $15.4 loss in State and local government pari-mutuel revenue withholding caused, the end result of the withholding system was to reduce overall government revenue by $12.3 million in 1977. This effect is coupled with the significant negative revenue impact on the industry and its participants, resulting in a huge annual revenue loss caused by withholding. The foregoing statement of the actual effect of the withholding system is summarized in the following table:

REVENUE EFFECT OF WITHHOLDING

		In Millions of Dollars
Gross Monies Withheld in 1977		$100
Less Amounts Over-Withheld:		
(A) Withheld From Persons Not Required to File	($ 2.4)	
(B) Excess Withholding From Persons With		
(a) No Tax Liability		
(b) Partial Refund Due Taxpayer	($29.6)	($32)
=Adjusted Tax Collections From Withholding:		$68
Less:		
(C) Withheld From Taxpayers Who Complied Voluntarily:		($59)
=DIRECT REVENUE YIELD FROM WITHHOLDING SYSTEM:		$ 9

NEGATIVE IMPACT OF WITHHOLDING ON GOVERNMENT REVENUES

(D) Decrease in Revenues Due to Decreased Cash Flow		
(a) To State and Local Governments	($15.4)	
(b) To Pari-mutuel Industry	($24.9)	
(c) To Federal Government	($ 5.9)	($ 5.9)
(E) Total Direct Negative Impact	($46.2)	
ADJUSTED FEDERAL REVENUE YIELD ($9 Million Less $5.9 Million - See (D) (c))		$3.1

THE EXISTING TAX TREATMENT OF LEGAL PAYOUTS DISCRIMINATES AGAINST PATRONS OF LEGAL GAMBLING OPERATIONS

The administration of existing Federal tax law discriminates against patrons of State-authorized gambling operations. Unnecessarily low reporting thresholds require legal operators to report large numbers of payouts that produce no real tax liability. Moreover, while the law provides for the deduction of documented losses to the extent of winnings, the standards for documenting losses are inconsistently applied by IRS and as a practical matter are impossible for the vast majority of bettors to meet. Further, even if a bettor is able to document his losses to the satisfaction of IRS he is unable, under the present law, to declare them unless he gives up the standard or zero-bracket deduction and itemizes his losses. And, bettors are unable, under the present law, to receive credit for losses that exceed current year payouts even though the vast majority of bettors must be net losers over the long term. The impractical nature and general unfairness of the existing tax treatment of legal payouts was recognized by the Federal Gambling Commission, which concluded that the law and its administration by IRS encouraged illegal gambling:

> "(t)he requirement that a player be able to prove both his winnings and his losses is not one that can be realistically met by the gambler, particularly with respect to casino gambling....It is generally accepted that few bettors are net winners during a given year or, for that matter, during their gambling careers; most bettors sustain a net loss (emphasis added). Those who have a winning year, and properly declare their winnings, are not permitted to carry back or carry forward losses from previous or subsequent years as a deduction from other income. This encourages patronage of illegal games..."

THE STATE-AUTHORIZED GAMBLING INDUSTRIES URGE CONGRESS TO ENACT H.R. 4592/S. 1861

The legal gambling industries of thirty-two States urge the Congress to adopt the recommendation of the Federal Commission on the Review of the National Policy Toward Gambling and end withholding from legal payouts.

The repeal of subsection (q) of section 3402 of the Internal Revenue Code would substantially increase the flow of gambling revenue to the States and strengthen legal gambling industries that are important sources of State revenues. By ending withholding Congress would significantly reduce Federal interference with State initiatives to eliminate illegal gambling by authorizing legal alternative wagering services. The combined effect of these results would be to restore to the States their traditional responsibilities in the area of gambling policy.

The $10,000 threshold for information returns for legal payouts from wagering transactions presently required to be reported would ensure reporting of nearly all wagering transactions involving real tax liability while greatly reducing the present costs to legal gambling industries of administering the Internal Revenue Code. The effect of this provision would be to increase the revenues of the State, county, and municipal governments that derive essential revenues from legal gambling.

Finally, the three-year carryover of wagering losses H.R. 4592 would provide would enable taxpayers to receive the tax credit for such losses that was intended by Congress when section 165 (d) of the Internal Revenue Code was drafted. In view of the finding by the Federal Gambling Commission that virtually all players sustain net losses over their gambling careers the inability of taxpayers, under section 165 (d), to carry legal losses over to preceding or subsequent years is unfair, and needlessly encourages players to gamble illegally. The carryover provision of H.R. 4592/S. 1861 would bring a badly needed measure of equity to the Federal tax treatment of legal wagering transactions.

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National Association of State Racing Commissioners
National Cutting Horse Association
National Horse & Pony Youth Activities Council
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Ohio Division - Horsemen's Benevolent & Protective Association
Ohio Harness Horsemen's Association, Inc.
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Pacific Coast Quarter Horse Racing Association
Professional Horsemen's Association of America, Inc.
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The American Greyhound Track Operators Association

Chairman STARK. Thank you very much, Mr. Fitzgerald.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I want to thank the panel, and also thank you for your patience. We usually keep the best panel for the last one. You have made a very good presentation, and it is going to be very helpful to us.

May I ask you, do any of you believe that repeal of the withholding requirements for gambling would reduce tax collections if this proposed legislation is approved?

Mr. KEENAN. In a very minor way, if at all, Congressman. As the Assistant Secretary said this morning, it is not a revenue issue. Their own estimates are somewhere between, as I understand it, $3 million and $22 million.

Mr. DUNCAN. Do you think the allowance of a carryover for gambling losses would be difficult to administer? Mr. Fitzgerald, would you like to answer?

Mr. FITZGERALD. No, I don't think it would be difficult. I think if it were spelled out, we could get the information to the players. I think it would be better for the Federal Government, as well as for the State, and certainly for the industry. I think you will get all the money right back in what we call the churn. The money will come back, be replayed, and taxes will be paid on it.

Mr. DUNCAN. Mrs. Ringquist, do you think that the repeal of the withholding requirement would move money from the illegal gamblers to the legal operations?

Mrs. RINGQUIST. I certainly hope it would. I must confess that the gambling aspects are not my strong point.

Mr. DUNCAN. Would any of the rest of you care to comment on whether it would move money from the illegal operations to the legal operations?

Mr. KEENAN. I don't think there is any question about that.

Mr. DUNCAN. Are you talking about a lot of money, or just a small amount?

Mr. KEENAN. I think a lot of money.

Off-track betting went into business, as I said, to raise money for local government, and also to curb illegal gambling. Frankly, bookmaking is back in pretty big business, at least in my area, in New York City it is now, and it was out of business in the early 1970's.

I was in a career law enforcement person, I was in law enforcement for 23 years, and there was a significant period where there was no horse betting at all as a practical matter in the early 1970's in New York City. Now the bookies are operating again.

Mr. DUNCAN. In off-track betting, how much do you do in New York City?

Mr. KEENAN. In New York City, $890 million we will do this year as total handle which generates $145 million in revenue.

Mr. DUNCAN. Do you have off-track betting in the entire State or just in the city?

Mr. KEENAN. Yes, we have it throughout the State of New York. In the State of New York, it generates a handle of $1.4 billion, and the total revenue is about $225 million.

Mr. DUNCAN. Would you venture to say that some of that was going to illegal gambling before you legalized off-track betting?

Mr. KEENAN. Absolutely, there is no question about it.

Mr. **Duncan**. Thank you very much.

Thank you, Mr. Chairman.

Mr. **Schmidt**. Congressman Duncan, the IRS, by its own estimates, has come up with a figure of $12 to $15 billion of book-type betting in the United States. A definite portion of that could be channeled into legal pari-mutuel wagering.

In addition to that, the Crime Commission in the State of Illinois did a study on this and came to the very definite conclusion that there was substantial illegal betting going on that belonged in the pari-mutuel industry, and that the loss of revenue to the State was substantial.

Mr. **Duncan**. Would anyone else care to comment?

[No response.]

Chairman **Stark**. Mr. Guarini.

Mr. **Guarini**. Thank you, Mr. Chairman.

Mr. Keenan, I couldn't help but think, when you mentioned all that money that goes through off-track betting in New York, why New Jersey never got into the act. You must be taking some of our money from us.

Mr. **Keenan**. No. You are taking plenty over at Mr. Mulcahy's.

Mr. **Guarini**. I want to also say to Bob Mulcahy that I am certainly proud of the great job that he has done in New Jersey in the growth of the breeding and racing industry, which has really created a tremendous number of jobs in New Jersey, and the central role that he played in the development of the entire sports complex, which goes into other sports besides horse racing. As you know, both standard breeders and the thoroughbreds racetrack has really grown to great national reputation.

I also want to thank you for your remarks, Bob.

I think there is another point that you could bring out, and that is that the Meadowlands Sports Complex, of which you are the chief executive officer, not only gave thousands of jobs to the people in the area, but it was also a catalyst for the development of that whole Meadowlands basin which is now, perhaps, the hottest real estate development area in the East.

I thought that you might want to make a point on that because that catalyst means tens of thousands of jobs and undeveloped property which has really taken off as a result of the catalytic presence of the Sports Complex.

Mr. **Mulcahy**. Congressman, you are absolutely right, not only the 3,000 jobs in construction and the 3,000 daily jobs that exist there now, but the Sports Authority has been credited with being the catalyst by some 15 years with moving the development of the Hackensack Meadowlands District.

To date, over $800 million have been invested in there by 400 to 500 companies. It has just been one of the greatest examples of rebirth of an area that I can think of anyplace, not only in this country, but in this hemisphere. It was a garbage dump.

Mr. **Guarini**. Yes.

Mr. **Mulcahy**. And people have to understand that.

Mr. **Guarini**. 102 municipalities dumped there.

Mr. **Mulcahy**. That is correct, and it has been reclaimed.

Mr. **Guarini**. It was the racetrack and the revenue from the gambling that actually was the basis for the development of the entire sports complex. It would never have happened were it not for that one foundation.

Mr. MULCAHY. Without the racetrack, Congressman, there would be no sports authority.

Mr. GUARINI. And without that, there would be no Meadowlands.

Mr. MULCAHY. That is correct.

Mr. GUARINI. I would like to ask Mr. Stone. Do you believe in the carryover of the losses, not necessarily that we should place against the winnings, but if there are losses that they should carryover, because that has been remarked upon earlier?

Mr. STONE. It is my personal opinion that that is the least important part of the bill that we have in front of us.

You have heard testimony about the confusion of turning in winners and losers. Most of our customers are losers. They just have to go in their pockets sooner when you take withholding from them, and they have to get pumped up again before they come back to the track.

It is entertainment. It is handicapping. It is a skill, a pleasure, exciting, and it is fun. You are just helping to make them go back into their pocket to help support our industry. It is a small part of the total industry when you look at the total numbers and the number of people involved in the gigantic figures of this great industry.

But to us, it is extremely important because, as you heard also, we have four racetracks in Kentucky, two are doing very well and two are doing very poorly. Our State legislature is in session right now, and our industry is fighting hard for our State to give these two tracks some tax credit to keep them in business. It will be a terrific loss to the State economy if they go out of business.

You see this happening all over, with the inflation, the cost of doing business, the labor unions, the demands by horsemen for purses, this is putting more and more pressure on the tracks, you are going to see more and more nonproprietary tracks in existence. The States probably will not let them go out of business because they want to keep some revenue, but there is going to be less and less for the States to keep.

The trend is there, and I don't see it stopping. Even the amount of money we are talking about, which is small to the Federal Government, is big to our industry and it is very important.

Mr. GUARINI. Thank you.

If people are able to take losses, I can see another side effect that you would perhaps save the littering of the racetrack with all the losing tickets that become so obvious at the end of the eighth race. So it would perhaps eliminate some of the sweepers that you need.

I also want to acknowledge the fact that Bob Juliano has been here accompanying Mr. Murphy, who is an official with the Service Employees International Union.

I assume that the remarks that you made, Mr. Murphy, would be adopted by Bob Juliano also?

Mr. MURPHY. Yes, they would. He also has a supporting statement.

Mr. GUARINI. I only have one last observation. It appears to me that there was no one here all day long who testified from the State of Florida. Perhaps one of the reasons for that is that they found oil under one of the racetracks, and perhaps they don't have to depend upon wagering or pari-mutuel betting.

Did any of you gentlemen have that good fortune with your hotels or racetracks?

Mr. Fitzgerald. No.

Mr. Guarini. That is what is called a double winner.

Thank you.

Chairman Stark. Mr. Schulze will inquire.

Mr. Schulze. Thank you, Mr. Chairman.

Mr. Chairman, I first would like to congratulate this panel on giving a very comprehensive overview. You have made a very strong and compelling case and argument, and that is not often done in the manner in which it has been done today.

I would also like to congratulate Mrs. Ringquist. I thought her presentation was very interesting and unique. I have never really thought of racing's various aspects as you presented them, but it was a very interesting presentation. I thank you for it.

If I am not mistaken, Mrs. Ringquist, weren't you one of the former owners of Secretariat?

Mrs. Ringquist. Yes. Now I am raising all the losers that he would have paid for.

[General laughter.]

Mr. Schulze. The point that you made, the breeder and owner takes, perhaps, a greater gamble than the bettor at the track, is a very good one.

I also think that you do contribute a great deal to the well-being of our society and our economy by those well-manicured horse farms. They are very pleasing as well, and I appreciate that.

It seems to me, from the Secretary's statement, that what we are not talking about here is a large amount of revenue one way or the other. So what it boils down to is—is taxation of gambling winnings in our society's best interest? It seems to me that that in turn sort of boils down to, does it encourage or inhibit criminal activity?

How many of the members of the panel have any kind of a law enforcement background?

Mr. Keenan, are you the only one? I realize in your statement you did say that the purpose of off-track betting was to fund government and to reduce massive illegal gambling that afflicts society by diverting off-track wagers from criminal channels and directing this revenue to constructive use.

From your background in law enforcement, would the reduction or the elimination of this withholding be beneficial to our society, or would it be a detrimental step?

Mr. Keenan. I think it would be beneficial to society because I think it would reduce illegal gambling. I don't think there is any question but that legal gambling is not really competitive with illegal gambling when the legal winnings are taxed, and particularly when they are withheld.

Obviously, the customer, the player, the bettor, wants to go where he is going to get the better price. If there is no withholding, and if there is no tax, the bookmaker then pays him the better price.

Mr. SCHULZE. Mr. Keenan, did I hear you say that you were in law enforcement for 23 years?

Mr. KEENAN. Yes. I was Chief Assistant District Attorney in New York County, and formerly the special prosecutor for corruption in New York City.

Mr. SCHULZE. From your background and experience, and in talking to other law enforcement officers and agencies, do they pretty much agree with your position?

In all candor, we on this committee should not only be concerned about tax revenues, but also about our society as a whole, and that is what we are talking about here. I would like to know whether other law enforcement agencies agree with your opinion?

Mr. KEENAN. Yes, they do, pretty unanimously, Congressman. As I indicated, and I know you are aware, the Federal Commission on Gambling, which was composed of Members of both the House and the Senate, and other distinguished citizens, pointed out in their report, just as we are attempting to point out today, that taxation drives people to the illegal games. What it does, it helps the underworld and, frankly, it helps organized crime. There is no question about it.

Mr. SCHULZE. It seems to me in our zeal to get every last buck for the Federal Government, we have gone too far in this instance.

Does anyone on the panel have anything they would like to add to what they have said?

Mr. FITZGERALD. I would like to ask permission for our counsel, Mr. Ritchie, to be able to put some more documents in the record.

Mr. GUARINI. Would Mr. Ritchie like to make a statement? We well know Mr. Ritchie for his good work here in Washington. You are a former law enforcement officer, are you not, sir?

Mr. RITCHIE. Yes.

We may file additional statements.

Mr. GUARINI. Yes. The record will be kept open for 5 days for any additional statements to be made by you or any other member of the panel.

[Mr. Ritchie's prepared statement and subsequent letter follow. Additional materials submitted by Mr. Ritchie have been retained in subcommittee files.]

Statement by
James E. Ritchie
former Executive Director of the
Commission on the Review of the National Policy Toward Gambling

Mr. Chairman, Members of the Committee:

It is a distinct privilege to appear before you today and to review with you the Findings and Recommendations of the National Gambling Commission as they are germane to your consideration, and to share with you some of my own observations in having considered the problem of gambling policies in this Country.

As you will recall, Congress created the Commission on the Review of the National Policy Toward Gambling in the Organized Crime Control Act of 1970 (P.L. 91-452). The Commission was comprised of four members of the United States Senate (Senator McClellan-Ark., Senator Cannon-Nev., Senator Scott-Pa., Senator Taft-O.) and four members of the House (Congressman Steiger-Ariz., Congressman Hanley-N.Y., Congresswomen Spellman-Md., Congressman Wiggins-Ca.) and seven persons appointed by the President. The mission of the Commission was to study gambling as it exists in America and to develop recommendations for the states to follow in formulating their own gambling policies. Specifically, the Commission was charged with evaluating the existing policies and recommending to Congress any changes in those policies which Congress should consider.

In the three years of the Commission's operation, the Commission staff collected, reviewed and summarized all available material on gambling. Staff members and consultants prepared more than thirty research papers and surveyed every aspect of gambling. In addition, the Commission held forty-three (43) days of hearings at different locations in the United States and accepted testimony from more than two hundred-seventy-five (275) federal and state law enforcement officials and policy makers, persons involved in every phase of legal and illegal gambling, as well as ordinary citizens who reflected the way their communities felt about gambling.

The Commission's final report was published by the Government Printing Office and filed with the President and the Congress on October 12, 1976. I would like to review some of the matters from that report which I think are germane to the issues you may consider:

THE NATIONAL POLICY TOWARD GAMBLING

> The Commission believes that the states should have the primary responsibility for determining what forms of gambling may legally take place within their borders. The federal government should prevent interference by one state with the gambling policies of another, and should act to protect identifiable national interests. The Commission recommends that Congress consider enacting a statute to insure the state's continued power to regulate gambling.

There is great diversity among the states concerning legalization of the various forms of gambling. Thirty-one states permit pari-mutuel wagering on horse racing. Thirteen states conduct lotteries. Two states sanction casino gambling and varying treatments exist for dog racing, bingo, card-playing and off-track betting. To a considerable extent these different state policies have resulted from the holding of referendums in which the people themselves have directly determined the policies of their state.

This diversity of treatment reflects the fact that the populations of the states differ in their views on gambling. The Commission did not believe that the federal government that represents the nation as a whole should substitute its judgment for that of the individual states in this area. Gambling has customarily been controlled by state agencies which can be flexible and responsive to local demands; the Commission found no public interest in pre-empting this authority by the imposition of binding national standards. While the Commission expressed no predisposition as to the appropriate roles of state and federal governments in the regulation and control of other activities, it did believe that where gambling is concerned there should be a considered reluctance on the part of the federal government to interfere with state policies.

The Commission advised that the states should make the determination of what forms of gambling, if any, are to be permitted; how to operate or regulate those forms of gambling that are authorized; and what the objectives of any changes in present laws should be, based on such criteria as those presented to the states in the Commission's report. From a purely pragmatic standpoint, it was believed this would result in the evolution of more efficient and representative gambling policies in the United States as different states experiment with different approaches, discarding those that are unsuccessful and emulating those that have been effective in other states.

The Commission urged that the federal government, in the exercise of its regulatory and tax powers, should not unnecessarily impair state efforts to compete with illegal gambling operations, and that states who choose not to give legal sanction to gambling in some or all of its forms, should not have it imposed upon them by either their sister states or the federal government.

The proposition that the states should determine their own gambling policies is consistent with the historical role assumed by the federal government. Congress has generally protected the autonomy of the states, exempting gambling which is legal in the state where it occurs from the application of federal statutes. Indeed, Congress has justified this action as one designed to assist the states in the enforcement of their gambling laws. Accordingly, the national policy which assigns to the states the determination of what forms of gambling are to take place, is merely a reaffirmation of the present position of the federal government, except to the extent that the federal gambling statutes interfere with the ability of the states to set their own gambling policies. The Commission recommended that these "interfering" statutes should be revised, and to the extent that the practices of the federal agencies vary from this "national policy" standard, they should be changed. To that end, the Gambling Commission analyzed the enforcement history of each federal gambling statute and sought to determine if the effect of the law was compatible with the national policy espoused in its report.

NATIONAL POLICY APPLIED TO TAXATION

In many states gambling has been deemed an appropriate method of raising revenue to support the costs of government either through direct state operations or a system of licensing fees and taxes. The Commission did not question the authority given by the Constitution to the federal government to tax the operators of these state gambling operations. Nevertheless, the Commission believed that Congress should take great care in the exercise of its taxing powers so as not to arbitrarily discourage state policies. Not only might the federal government stifle state initiatives in raising revenues to meet the expense of state and local government, but federal taxes on state gambling operations and those who participate in these operations may render state government incapable of competing with those illegal games they seek as a matter of state policy to eliminate through the provisions of a legal alternative. It was recommended that the federal government should cooperate fully with the states so that inflexible taxation policies did not bring about unintended results.

Although federal taxation on gambling activities takes various forms (e.g., income tax on gambling winnings, individual and corporate income taxes on gambling business income, excise on gross wagers received by an individual in the business of accepting wagers, occupational stamp tax applicable to each person employed in the business of accepting wagers), all existing tax laws were passed primarily for the purpose of raising revenue and only secondarily to attack illegal gambling. Ironically they have been ineffective as revenue-producing measures and have contributed substantially to the success of illegal gambling operations. Congress must now view this situation realistically from the standpoint of the national policy of assisting the states in their revenue-raising efforts.

The Commission noted with alarm that the United States is the only country in the civilized world to impose an income tax on gambling winnings. Every other country taxed the operation but not those who were encouraged to support it and happened to win. Each country rejected a tax on winnings as being unenforceable due to lack of public support and resources to enforce such a tax, as well as being a negative impact on any legal game that was intended to be competitive with an illegal counterpart. The Commission concluded that based upon its evaluation of U.S. tax laws and their effectiveness that they were in agreement with each of these countries' reasons for rejecting a tax on gambling winnings. It seemed that each of these countries was satisfied with a tax upon one's wages allowing the remainder to be spent as disposable income without being subjected to an additional tax. The Commission did not disagree with this tax philosophy.

COMMISSION ANALYSIS OF INCOME TAX STATUTE

Section 61 of the Internal Revenue Code provides the basis for the taxation of all income from any source. Judicial interpretations of this section have consistently ruled as taxable any accretion to wealth... unless specifically exempt, thereby encompassing gambling winnings.

Section 165(d) of the Internal Revenue Code allows a specific deduction for gambling losses (from both legal and illegal sources) up to but not exceeding the extent of gambling winnings.

Since most persons wager for entertainment and as a hobby, the added burden of income taxes on such chance or windfall gains tends to encourage those few bettors who do win to evade taxes on these gains. It is generally accepted that few bettors are net winners during a given year or, for that matter, during their gambling careers; most bettors sustain a net loss. Those who have a winning year, and properly declare their winnings, are not permitted to carry back or carry forward losses from previous or subsequent years as a deduction from other income. This encourages patronage of illegal games; the winner in an illegal game can ignore the doctrine of voluntary compliance because he knows that the illegal operator will not report the win to the IRS.

There appears to be almost no voluntary compliance with the reporting and payment requirements relating to the taxation of gambling winnings. Under current regulations, offices accepting legal parimutuel wagers must file information returns (and now withholding) for wins of more than $600 ($1,000) involving bets and winnings with odds higher than 299 to 1. Apart from the income reported under this provision -- a very small fraction of total parimutuel winnings -- the Internal Revenue Service is unable to distinguish reporting of gambling winnings on personal income tax returns because these winnings are reported as 'Other Income,' and no distinction for gambling winnings is required under this category. The Internal Revenue Service reports having no resources specifically devoted to enforcing this provision of the Internal Revenue Code. In materials provided to the Commission, the IRS stated that the present tax laws affecting gambling winnings are operating in 'a highly unsatisfactory manner.'

In 1960, the IRS did direct special monitoring procedures toward filing of information returns by racetracks and the reporting of gambling income by racetrack patrons. These procedures were terminated two years later, after the IRS concluded that compliance by both racetracks and bettors was satisfactory. However, despite the adequacy of these reporting procedures for extraordinary wins at unusual odds, average gambling winnings from legal sources apparently go unreported, as do winnings from illegal bookmakers.

It is apparent that the law requiring payment of taxes on gambling winnings will always suffer from a lack of voluntary compliance. The requirement that a player be able to prove both his winnings and his losses is not one that can be realistically met by the gambler, particularly with respect to casino gambling. Even in the case of racetracks, where each transaction produces a record, a requirement that each bet be assigned a unique bettor's number (which would potentially prevent a winner from simply picking up enough losing slips to cover his winnings) is not one that can be reasonably imposed. As previously discussed, the current reporting requirement arbitrarily selects a group for special treatment.

While the Federal income tax provisions relating to gambling do not serve to protect the interests of one State from the gambling policy decisions of another, they do nevertheless involve other substantial State, as well as national, interests. It is apparent that taxes on legal gambling winnings serve to deter the bettors from using legal betting facilities when faced with a choice between legal and illegal games. Testimony before the Commission made it clear that existing Federal tax policies make any meaningful competition between legal and similar illegal games impossible. A State that sees legal gambling as a technique for depriving illegal operators of their market may choose to exempt legal winnings from their State income tax; however, that approach would be defeated by retention of the existing Federal tax provisions. The current tax policy is tantamount to an inducement to the regular or heavy bettor to participate in illegal games.

The Commission believed that by giving a competitive edge to illegal facilities (which may in turn contribute their revenue to organized crime or other criminal cartels) the current tax policy on gambling winnings condemns to failure the efforts of a State to construct a legal alternative. It might therefore be concluded that the current tax policy contributes to the success of gambling operations run by criminal elements. Certainly this was not the intent of Congress.

The Commission was aware that its recommendation on Federal taxation of gambling participants is the most central and, consequently, the most controversial one it has been called upon to make. For this reason, its decision was not reached easily or without great care. It was the sense of the Commission that Congress should do all within its power, consistent with the national policy, to insure freedom of competition between burgeoning legal gaming industries and existing illegal gambling operations. If this is to be done, a different and consistent treatment of Federal tax policy is essential. Taxation of legal gambling winnings is the most critical issue affecting the right of each State to compete in the gambling arena and it is clear to the members of the Commission that the present policy has a totally negative effect.

The attention of the States must be drawn to the deterrent effect of a tax policy, similar to the federal policy whether they are motivated by revenue-raising or law enforcement considerations. It is also appropriate for the States to review their present policies to determine whether the advantages that are derived from legal gambling operations may be offset by the advantage given to the illegal gambling community by Federal tax policies.

It is true that, in this country, gambling has traditionally been viewed as an activity that has a negative impact upon society and one that should therefore be taxed. Yet in many States it is now a subject of State entrepreneurship, run by the State, controlled by the State, and providing revenue to the State. In such instances, exclusion of winnings from Federal income taxation should not be considered a promotion of gambling, but rather, an acceptance and encouragement of State policy predicated upon a mandate of the people of that State, as well as an anticrime measure of assistance to law enforcement. It is quite possible that Congress might want to distinguish, for tax purposes, between gambling businesses conducted by a State and those legalized by a State and operated by private enterprise. While this would not go far enough in terms of allowing free competition between legal and illegal gambling industries, it is certainly a position far preferable to that presently in effect. The overriding concern of the Commission in this area was the prevention of Federal interference in the domain of State production of revenue. To the extent that the legal gambling industries provide revenue to the States, the existing Federal tax policy is in contravention of the national policy which is recommended by the Commission. The recommended policy was to leave to the States the determinative jurisdiction over the legalization of gambling. To this end, THE COMMISSION RECOMMENDS THAT WINNINGS DERIVED FROM LEGAL GAMBLING ENTITIES BE EXCLUDED FROM GROSS INCOME, WITH THE AFFIRMATIVE BURDEN BEING PLACED UPON THE TAXPAYER TO DECLARE THE INCOME AND PROVE THE LEGALITY OF THE SOURCE. (It was part of the Commission's recommendation that, in order to receive the benefit of the exclusion, an individual would be required to make on his or her income tax return an affirmative representation of having received winnings from a legal, identified source. The IRS would formulate the appropriate reporting requirements and design a suitable form which would set forth verifiable information establishing the validity of the representation.)

This recommendation is not to be construed as applying to the professional gambler: If a person's trade or business or his primary source of income is gambling, a statutory distinction must be provided to deny the exclusion. This distinction would also apply to operators of primary gambling enterprises, whether they are individual or corporate entrepreneurs. This recommendation should not be viewed as in any way favorable to those who engage in illegal gambling. The affirmative burden of proof as to the legality of the source is meant as a safeguard against this possibility; the applicable provisions of fraud and falsification of returns would be available against those who provide improper documentation, and these violations are more readily proved than is an understatement of income by an indirect method of proof.

The Commission recognizes the potential legal and practical difficulties that could arise from the immediate application of this tax policy to all legal games. Consequently, THE COMMISSION RECOMMENDS THAT IMPLEMENTATION OF THIS POLICY BEGIN WITH ITS APPLICATION TO STATE OPERATED GAMBLING ENTERPRISES: should this experience show justification for continuation of the policy, it could then be made applicable to other legal gambling industries.

Withholding

An issue related to taxation of winnings is the withholding of income in anticipation of potential taxes. Such measures are contained in 26 U.S.C. 1441 (a), requiring the withholding of 30 percent of all income earned by nonresident aliens, including gambling winnings. That the IRS favored expansion of this concept to other categories of gambling winnings, applicable to U.S. citizens is evidenced by its support of the withholding provisions of the Tax Reform Act of 1976.

The new act (1976) provides for withholding of 20 percent of all 'proceeds of more than $1,000 from a wagering transaction, if the amount of such proceeds is at least 300 times the amount wagered.' The bill raises the withholding limit to $5,000 or more won in a State lottery, removes the 300-to-1 odds, requirement from 'sweepstakes, wagering pools, and other lotteries' and excludes bingo, keno, and slot machines from its provisions. Casino games, by omission, are exempt as well.

Congressional interest in this withholding measure is understandable, since, in testimony before the Senate Finance Committee, officials of IRS estimated initially that such a measure would generate $500 million in revenue to the Government; the following day that figure was reduced to $110 million. There is no evidence to support either estimate.

The Commission believes that the expansion of the withholding concept as it applies to parimutuel wagering will not raise additional revenues to the Government. The administrative burden to the operator of the legal industry to collect these funds is only one immediate concern, however; the likely impact of the requirement driving previous legal participants to illegal games is of greater concern, unless, of course, one is prepared to suggest that Congress specifically intended to increase the competitive advantage the illegal games presently maintain over their legal counterpart. Indeed, no factual basis has been provided to establish the validity of the estimate from IRS that $110 million will be realized by withholding 20 percent of all winning wagers exceeding $1,000 from parimutuel betting. Without such a factual justification, it would only temporarily be in the Government's possession, since losses in any given year will undoubtedly exceed winnings, entitling the return of these proceeds to a taxpayer.

The application of the withholding provision to State lottery prizes over $5,000 is even more questionable. A study conducted by IRS clearly established that all State lotteries properly filed information returns reporting winners of over $600 and that 85 percent voluntarily reported and paid their taxes on such winnings. If these data from IRS are accepted, it is hard to envision any need for additional measures of collection and it engenders skepticism about the claim of $500 million in additional revenues that are supposed to accrue from such a measure.

Effect of Withholding

The Commission reviewed this legislation and its likely impact on both legal gambling industries and individual participants in games of chance. It examined the possibility that substantial administrative burdens might be imposed upon legal gambling businesses, and that illegal forms of gambling might become more attractive to the players, thereby reducing revenues to the States and increasing illegal gambling. It questioned whether there is a real correlation between winnings on a given day and the overall tax liability of the participant, since gambling losses are deductible from winnings over the course of a year and most players lose on balance. It sought to determine the amount of revenues that would ultimately be raised by such a measure and whether such revenues would warrant the administrative expenses and social and economic consequences involved. Using these criteria, the Commission seriously questioned whether the new withholding measure would serve to further any identifiable national interest; indeed, it would appear that such withholding interferes with policies on numerous State governments.

... It appears that Congress has once again formulated a clearly discriminatory practice against selected gambling industries based on what is apparently a very inexact estimate of the anticipated revenue. CLEARLY, IF THE EXISTING POLICY OF TAXING GAMBLING WINNINGS FROM A LEGAL STATE ENTITY IS QUESTIONABLE, THEN THE EXTENSION OF THAT POLICY BY WITHHOLDING ON OTHER SELECTED LEGAL WAGERING ENTITIES IS INSUPPORTABLE.

Consequently, the Commission concluded that the withholding measure will increase the advantage to illegal operators, generate minimal revenues to the Government, and unnecessarily increase the administrative burden to the legal gambling businesses. THE COMMISSION RECOMMENDED THAT CONGRESS REEXAMINE THE PROBABLY IMPACT OF SECTION 1207(d) OF THE TAX REFORM ACT OF 1976. IF, UPON REEXAMINATION, CONGRESS FINDS THE PROPOSED WITHHOLDING TAX TO BE DESTRUCTIVE OR EXISTING LEGAL GAMBLING INDUSTRIES, THE COMMISSION RECOMMENDED THAT THESE WITHHOLDING PROVISIONS BE REPEALED.

A review of the Canadian approach to windfall gambling winnings was conducted at the Commission's request. Canadian tax officials at the national and field levels were interviewed to obtain their views and experiences. Canadian law enforcement officials were also consulted to determine what effect, if any, Canadian tax policies on gambling winnings have on law enforcement efforts as they relate to illegal gambling.

The Canadian officials were unanimous in support of the exclusion of windfall or chance gains from taxation. They stated that this exclusion from income has not caused any adverse impact on tax revenues and, further, that it has not proven to be a problem in tax fraud cases in which the net worth method of proof was employed.

In the past, Congress has consistently encouraged State revenue-raising endeavors by providing them with favorable tax treatment. For example, a person who, in effect, lends money to a State through the purchase of a bond has the benefit of receiving tax-free interest. Likewise, the imposition of certain State taxes -- such as income, sales, and gasoline taxes -- is partially offset by the allowance of deduction of these payments on Federal income tax returns. THE COMMISSION RECOMMENDED THAT CONGRESS -- TO BE CONSISTENT -- SHOULD PROVIDE EQUAL TAX TREATMENT FOR LEGAL GAMBLING ENTITIES THAT ARE OPERATED BY A STATE. This would provide a nondiscriminatory application of these incentive policies and would assist the States in becoming competitive with the illegal games.

CONCLUSION

As the Director of the Commission and a former federal prosecutor involved in the enforcement efforts against organized crime, I have had a unique opportunity to examine the subject of gambling in its entirety. I am aware that the Commission's effort is the first of its kind and that this issue has not been previously examined or investigated in a similar manner. Having seen gambling in such comprehensive detail, has considerably broadened my perspective toward it and has led me to the inescapable conclusion that we as a country can no longer afford to be ill-informed or complacent about gambling policy. If, in fact, existing policies accomplish little for the minority of the people and frustrate the will of the majority, those policies should not be perpetuated. As near as was scientifically possible, the Gambling Commission established an inescapable fact, that gambling in this country is inevitable; that is, it is tacitly endorsed or practiced by a majority of adult Americans. Two-thirds of all adult Americans placed a wager in the base year of our survey. Eighty percent of those same persons favored one form of legalized gambling or another.

The present policies and practices of our federal system are based upon a sincere belief that laws against gambling have an adverse effect upon illegal gambling. It is my conclusion and that of the Commission that those policies and that system have an effect only upon legal gambling. I am sure that the members of the Committee are impressed with the quality of individuals who appear before you in support of legislation. These individuals who represent the thousands of people involved in their gaming industries are a credit not only to their particular enterprise, but also to their country. These individuals involved in the legal gaming industry in this country have been discriminated against and for no good purpose. It has been my pleasure to become acquainted with them and to seek their counsel in the work of the Commission. Through these efforts I have been made aware of the effect of these discriminatory practices on their business and in turn upon the revenue their business produces for state and federal governments. In a manner which I hope is appropriate, I appeal to the Committee to remove these discriminatory treatments from the tax practices of our government. I ask that you recognize the clear and convincing evidence that by maintaining discriminatory practices that affect only the legal enterprise that the biggest beneficiary to such a system are the illegal operators who accept willingly bettors who wish to wager, and are encouraged by these tax practices to support the illegal operator.

Thank you for your attention and courtesy.

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April 6, 1982

The Honorable Fortney H. (Pete) Stark
Chairman
Subcommittee on Select Revenue Measures
House Committee on Ways and Means
1136 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

On behalf of my clients and others within the industry, I am submitting this letter for the record in order to clarify certain issues raised in the hearings on March 16, 1982, to support H.R. 4592. Specifically, these topics were alluded to in our oral testimony and can be substantiated by our supporting documents and studies which have been submitted for the record.

I. PAYOUTS DO NOT EQUAL INCOME, AND WITHHOLDING IS NOT AN AUTOMATIC COLLECTION DEVICE.

The 1977 IRS Compliance Study shows that under current low thresholds more than 250,000 Form W2-Gs are filed annually - far more than in infrequent "special types of wagers" which produce the "unique and occasional windfalls" that may result in a year-end tax liability. Moreover, independent studies of government-operated off-track betting (OTB) and casino gaming show that most W2-G winners are not occasional bettors but have high and consistent levels of betting activity. Our studies specifically show that a) on average, W2-G winners at OTB facilities bet 20 times per month with OTB and also bet frequently at the race track, and b) casino W-2G winners take nearly ten gambling trips and gamble an average of 22 days per year, thus, losing an average of $1,000 per annum.

Especially in pari-mutuel betting, the common practice of placing large numbers of bets over extended periods of time is reflected in the large percentage of bettors who file multiple W2-G Forms; for example, 30 percent of the W2-G winners at OTB facilities file more than one W2-G Form. The very high odds against winning even one W2-G pari-mutuel bet in the course of a year mean these multiple W2-G payoffs are typically the product of large numbers of losing wagers. It must be emphasized that "ten percenters" - persons who cash the winning pari-mutuel tickets of other bettors for a 10% commission - are a tiny minority of multiple W2-G Form filers: the IRS Compliance Study found only 1,000 ten percenters among the 118,164 individuals filing W2-G Forms and pari-mutuel horse racing, dog racing, and jai-alai payouts in 1977 - fewer than 1% of this group of taxpayers.

These figures show that reportable W2-G winnings are not due to the chance or occasional "lucky" bet but rather occur because of consistent play over an extended period of time. It is suggested that reporting levels should be significantly raised to $10,000 under H.R. 4592 in order to reach the true "windfall" win.

The fact that the great bulk of currently reportable W2-G payoffs are not taxable income is conclusively demonstrated by the discrepancy between the $100 million IRS estimates is withheld from payouts annually and the March 16, 1982 estimate of the staff of the Joint Committee on Taxation that the repeal of withholding would reduce Treasury's tax receipts by only $17 million. Importantly, this $17 million represents only "first order" effects, or the direct reduction in Treasury receipts the repeal of withholding would cause; independent industry studies indicate that these first order effects may be as low as $9 million, and would in any case be wholly offset by increased Federal income tax collections from the growth in legal gambling industry revenues that would follow the repeal of withholding and increased State and local government gambling revenues. When these second order effects are taken into account the revenue estimates for H.R. 4592 show substantial net revenue gains for government, as well as an improved employment picture for the legal gambling industry.

That legal payouts represent a negligible tax base is not in dispute. Assistant Secretary Chapoton testified on March 16, 1982, in response to questions from Representatives Holland and Moore, that the revenue loss implications of ending withholding are not a major revenue item. It is, moreover, hard to see how the current provisions "reduce the tax agency's audit and collection workloads." With currently low threshold levels, the number of W2-G forms (around 250,000) creates a workload that could be significantly reduced with more realistic thresholds. Independent industry studies indicate that raising the reporting threshold to $10,000 would, we believe, eliminate 90 percent of the cost of administration while still obtaining a major portion of the real tax liability produced by legal payouts.

II. WITHHOLDING IS NOT AN IMPORTANT COMPLIANCE TOOL.

The argument that withholding is needed to collect at least a portion of the tax due from winners who fail to file income tax returns is contradicted by the IRS's own 1977 Compliance Study. The Study found that only 3.7% of W2-G recipients were "delinquent filers or people who refused to file returns. This is a lower rate of nonfiling than ... found among taxpayers generally ... GAO (the General Accounting Office) estimates that of the 68 million people required to file income tax returns in 1972, 5 million, or over 7 percent were delinquent." The IRS Study moreover found that the "delinquency rate ... was almost identical for taxpayers whether or not they were subject to withholding."

The IRS Study similarly fails to prove that withholding is necessary to ensure the reporting of legal payouts. According to the Study the average compliance rate for reporting payouts under withholding was 83.4% while under reporting (for keno and slot machines) this rate was 77.3%. The difference is small - only 6.1% - and in the opinion of a nationally known independent research firm may not be statistically significant. The IRS Study supports the contention that the size of the payout is a principal determinant of compliance. Payout size and compliance are strongly correlated in the IRS Study, the highest compliance rates being associated with the largest payouts. Additionally, the percentage of W2-G recipients reporting their payouts increases with the size of the payout. These relationships demonstrate that differences in compliance are dependent upon the size of the payout, and suggest that with respect to wagering transactions much of the connection between compliance and withholding is illusory. The conclusion, that withholding is necessary to ensure compliance in reporting payouts, is speculative in view of the IRS Study data.

III. WITHHOLDING PROVIDES A COMPETITIVE ADVANTAGE TO ILLICIT OPERATIONS.

The plain fact is that current law provides an incentive to bet illegally. Independent studies of OTB bettors show that more than 70 percent of the persons queried felt that existing withholding and reporting requirements encourage illegal gambling with bookmakers. That the taxation of legal payouts generally stimulates illegal gambling is too well known, and too widely accepted by law enforcement authorities in this country and abroad, to require further substantiation. The 1976 Final Report of the Federal Commission on the Review of the National Policy Toward Gambling and the 1978 Report of the Royal Commission on Gambling in Great Britian are only two recent examples of impartial government investigative bodies of unquestioned authority to arrive at the conclusion that taxing legal payouts is the principal cause of illegal gambling, which, further, is impossible to control through ordinary police methods. This issue has been examined by scores of government commissions in the United States and in other countries over the last half-century; not one such commission has produced evidence that would support the argument that withholding somehow encourages bettors to gamble legally and report their payouts to Internal Revenue. Therefore, a careful examination of these finds and the record presented in support of H.R. 4592 strongly indicated that the present withholding tax on legal gambling payouts does encourage and enhance illegal betting.

The elimination of withholding would not provide any net economic benefit to the legalized establishments because any win goes to the player. Of course, an increase in play would result in increased economic activity. The legal establishment would be more profitable thus, paying more taxes and additional employees would be hired to cover the growth. Legal gambling establishments benefit when players lose (or, in the case of pari-mutuel operations, when bettors simply continue to bet), not from players' reported or unreported winnings. The questions of whether players do or do not report payouts is in fact irrelevant to gaming establishments - aside from their general concern to conduct their business according to the laws - except insofar as withholding and unnecessarily low reporting requirements drive their patrons to illegal operators. As the IRS Compliance Study found, the legal gambling businesses' compliance with the existing reporting and withholding provisions is excellent: in the Study's words, "the payer community is doing an excellent job in attempting to comply with its reporting and withholding responsibilities." The industry's concern and the concern of a majority of the States as well, is with the adverse social and economic effects of the current tax policy towards gambling, and not, with some form of tax relief to increase the industries' profits at the expense of either Treasury or society in general. Any bet with any illegal bookmaker or illicit operation will never positively impact Treasury tax receipts or state revenue collections. Only legal wagers enhance either directly or indirectly governmental coffers, both state and federal.

We urge the Committee to act favorably upon H.R. 4592, and we thank you for this opportunity to revise and extend our collective remarks.

Respectfully submitted,

James E. Ritchie
Counsel,
Nevada Resort Association
Gaming Industry Association of Nevada, Inc.
National Association of Off-Track Betting, Inc.

mmc

cc: Select Revenue Measures Subcommittee

bcc: The Honorable Dan Rostenkowski
The Honorable Charles B. Rangel
The Honorable Jim Jones
The Honorable Harold Ford
The Honorable William M. Brodhead
The Honorable Thomas J. Downey
The Honorable Kent Hance
The Honorable Don Bailey
The Honorable John H. Rousselot
The Honorable Howard W. Cannon
The Honorable Paul Laxalt
The Honorable Jim Santini
The Honorable Walter D. Huddleson
The Honorable Alfonse M. D'Amato
The Honorable Daniel Patrick Moynihan
The Honorable Wendell H. Ford

Mr. **Guarini**. Mr. Tad Davis, do you wish to make any remarks at all?

Mr. **Davis**. Not at this time.

Mr. **Guarini**. Thank you for the very enlightening statements that you have all made. Each and every member of this very distinguished panel, we want to give you our special thanks.

We will adjourn the subcommittee until further call.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

APPENDIX

There follows the text, summary, and written comments received on bills which are the subject of this hearing.

Repeal of Income Tax Withholding on Certain Gambling Winnings

97TH CONGRESS
1ST SESSION

H. R. 612

To amend the Internal Revenue Code of 1954 to repeal the provisions requiring withholding of tax on certain gambling winnings.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 5, 1981

Mr. ROUSSELOT introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to repeal the provisions requiring withholding of tax on certain gambling winnings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (q) of section 3402 of the Internal Revenue Code of 1954 (relating to extension of withholding to certain gambling winnings) is hereby repealed.

(b) The amendment made by subsection (a) shall apply to payments of winnings made after the date of the enactment of this Act.

97TH CONGRESS
1ST SESSION

H. R. 2981

To repeal section 3402(q) of the Internal Revenue Code of 1954 which requires for income tax purposes, amounts to be withheld from certain gambling winnings.

IN THE HOUSE OF REPRESENTATIVES

APRIL 2, 1981

Mr. CHAPPELL introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To repeal section 3402(q) of the Internal Revenue Code of 1954 which requires for income tax purposes, amounts to be withheld from certain gambling winnings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (q) of section 3402 of the Internal Revenue Code of 1954 (relating to extension of withholding to certain gambling winnings) is hereby repealed.

SEC. 2. The repeal made by the first section of this Act shall apply to payments of winnings made after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

Withholding requirements

In certain circumstances, present law requires income tax to be withheld from gambling winnings at a rate of 20 percent (Code sec. 3402(q)). The general rule is that gambling winnings are subject to withholding if the amount of proceeds from a wager exceeds $1,000 and also is at least 300 times as large as the amount wagered.[1]

Special rules apply to certain types of wagers. First, all winnings of more than $1,000 from a wager placed in a sweepstakes, wagering pool, or lottery (other than a State-conducted lottery) are subject to withholding, regardless of the amount wagered. Second, winnings of more than $5,000 from a wager placed in a State-conducted lottery are subject to withholding, and winnings of $5,000 or less from such a lottery are not subject to withholding, regardless of the amount wagered. Third, winnings from a slot machine, keno, or bingo are exempt from withholding.

If these rules require withholding, the entire amount of winnings (not merely any excess over the $1,000 or $5,000 threshold amount) is subject to withholding. If multiple wagers are placed on a single event, the winnings on each such wager are aggregated to determine whether the $1,000 or $5,000 threshold is exceeded. For example, if one $100 and two $50 wagers are placed on a single horse in a race, amounts paid on the three tickets would be added together, and the price of all three tickets would be deducted, to determine whether the winnings were subject to withholding. On the other hand, if wagers are placed by one person on different horses or on different races, the bettor's winnings from the wagers would not be aggregated for purposes of the withholding requirements.

Required information reports

Any person who is to receive a payment of gambling winnings subject to withholding must furnish the payor with a statement containing his or her name, address, and taxpayer identification (social security) number (sec. 3402(q)(6)). A payor of gambling winnings must report payments subject to withholding to the Internal Revenue Service. Where gambling winnings are less than the threshold amounts for withholding, proposed Treasury regulations would permit a payor to rely on a written statement from the recipient in determining whether multiple wagers must be aggregated and income tax withheld (Prop. Reg. § 1.6011-3).

In the case of winnings from a slot machine, keno, and bingo (which are not subject to withholding), Treasury regulations require the payor to report to the Internal Revenue Service on winnings of $1,500 or more from keno, or $1,200 or more from bingo or slot machines (Reg. § 7.6041-1).

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[1] The statute expressly applies this general rule to such proceeds from a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai.

IRS report

The Tax Reform Act of 1976, which added the withholding requirement on the ground that "many taxpayers did not report" certain gambling winnings on their tax returns,[8] also required the Internal Revenue Service to report to the tax-writing committees on the operation of the reporting system on winnings from keno, bingo, and slot machines, and to make recommendations as to whether those winnings also should be subject to withholding.[9] In a December 1980 report ("Compliance in Reporting Gambling Winnings"), the Service recommended that, "because of the significantly greater compliance demonstrated by individuals subject to withholding as compared to those subject only to information reporting," (1) withholding should be required on winnings of $1,500 or more from keno and $1,200 or more from bingo and slot machines, and (2) the withholding threshold should be lowered to $600 for horse racing, dog racing, and jai alai wagers, if the amount of proceeds from the wager is at least 300 times as large as the amount wagered, and for sweepstakes, wagering pools, and lotteries (including State-conducted lotteries).

Issue

The issue is whether the present law requirements for income tax withholding on gambling winnings should be repealed.

Explanation of the bills

Each bill (H.R. 612 and H.R. 2981) would repeal the provisions of present law which require income tax withholding on gambling winnings.

Effective date

Each bill (H.R. 612 and H.R. 2981) would apply to payments of gambling winnings made after the date of enactment.

Revenue effect

It is estimated that each bill would reduce fiscal year budget receipts by $17 million in 1982, $53 million in 1983, $18 million in 1984, $18 million in 1985, and $18 million in 1986.

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[8] House Rpt. 94-658, 94th Cong., 1st Sess. (1975), at p. 297; Sen. Rpt. 94-938, 94th Cong., 2d Sess. (1976), at p. 383.

[9] House Rpt. 94-1515, 94th Cong., 2d Sess. (1976), at p. 488.

STATEMENT OF HON. BILL CHAPPELL, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, IT IS INDEED MY PLEASURE TO APPEAR TODAY IN SUPPORT OF MY BILL, H.R. 2981, WHICH WOULD REPEAL THE REQUIREMENT THAT TAXES BE WITHHELD FROM CERTAIN PARI-MUTUEL GAMBLING WINNINGS. SINCE THE ENACTMENT OF THIS TAX PROVISION, THERE HAVE BEEN SERIOUS QUESTIONS RAISED AS TO ITS FAIRNESS AND EFFECTIVENESS.

SECTION 3024(Q) OF THE INTERNAL REVENUE CODE, WHICH WAS ADDED IN 1976, REQUIRES THAT A PERSON MAKING PAYMENT OF CERTAIN GAMBLING WINNINGS, MUST DEDUCT AND WITHHOLD 20 PERCENT OF THE PAYMENT. WINNINGS FROM HORSE RACING AND OTHER PARI-MUTUEL OPERATIONS ARE SUBJECT TO THIS 20 PERCENT WITHHOLDING TAX IF THE PROCEEDS FROM THE TRANSACTION ARE OVER $1000 AND AT LEAST 300 TIMES AS LARGE AS THE AMOUNT WAGERED.

THIS PROVISION WAS ENACTED IN AN EFFORT TO ASSURE COMPLIANCE WITH THE TAX LAWS REQUIRING SUCH WINNINGS TO BE REPORTED AS GROSS INCOME. AT THE TIME PARI-MUTUEL WITHHOLDING WAS IMPOSED, THE I.R.S. PROJECTED THAT ANNUAL COLLECTIONS COULD POTENTIALLY REACH $500 MILLION. HOWEVER, WITHHOLDING AT PARI-MUTUEL FACILITIES IN 1980 AMOUNTED TO ABOUT $71 MILLION AND, TO DATE, THERE IS NO EVIDENCE THAT THIS FIGURE REPRESENTS A SUBSTANTIAL INCREASE OVER THAT WHICH WOULD HAVE BEEN COLLECTED THROUGH VOLUNTARY REPORTING.

MORE IMPORTANTLY, MR. CHAIRMAN, DISCUSSION OF THE WITHHOLDING ISSUE HAS FAILED TO ADDRESS THE COSTS INVOLVED FOR INDIVIDUALS AND THE PARI-MUTUEL INDUSTRY IN GENERAL. WITHHOLDING HAS PROVEN TO BE A SERIOUSLY DETRIMENTAL AND COUNTERPRODUCTIVE INTERVENTION IN THE BUSINESS RELATIONSHIP

BETWEEN THE INDUSTRY AND ITS PATRONS.

THE MOST IMMEDIATE EFFECT OF THIS FEDERAL INTERVENTION IS TO DECREASE REVENUES TO PARI-MUTUEL OPERATIONS. BECAUSE THE INDUSTRY RELIES ON WAGERING, CASH RETURN, AND REWAGERING TO SUSTAIN ITS FINANCIAL BASE, THE IMPACT OF WITHHOLDING IS FAR GREATER THAN THE ACTUAL AMOUNT WITHHELD. IT IS ESTIMATED THAT EACH RACE TRACK DOLLAR CIRCULATES THROUGH THE WAGERING SYSTEM AN AVERAGE OF 3.5 TIMES. CONSEQUENTLY, THE IMPACT OF A $71 MILLION 1980 WITHHOLDING WAS TO WITHDRAW FROM THE PARI-MUTUEL SYSTEM APPROXIMATELY $250 MILLION IN ECONOMIC STIMULUS AND BENEFITS. THIS MULTIPLIER EFFECT HAS ACTED TO PLACE SERIOUS RESTRICTIONS ON THE INDUSTRY'S CASH FLOW POSITION BY CREATING A GAP IN THE WAGERING STREAM.

OBVIOUSLY, NEGATIVE IMPACTS OF THIS PROPORTION ARE BOUND TO AFFECT OTHER SEGMENTS OF SOCIETY -- AND THEY DO.

ASIDE FROM THE IMMEDIATE EFFECTS ON INDUSTRY EMPLOYMENT AND HORSEMEN'S PURSES, THERE IS A NEGATIVE IMPACT ON STATE AND LOCAL REVENUES COLLECTED FROM PARI-MUTUEL OPERATIONS. RACE TRACKS ARE KEY CONTRIBUTORS TO INDIVIDUAL LOCAL ECONOMIES AND OFTEN GENERATE, THROUGH TAXES, EMPLOYEE SALARIES, AND GOODS AND SERVICES PURCHASED, A SUBSTANTIAL PORTION OF THE LOCAL CASH FLOW. WHILE INDIVIDUAL ECONOMIC IMPACTS VARY, RACE TRACKS HAVE BEEN DOCUMENTED TO GENERATE MANY MILLIONS OF DOLLARS FOR THE AREAS IN WHICH THEY ARE LOCATED.

BECAUSE THE WITHHOLDING PROVISION ONLY APPLIES TO CERTAIN TYPES OF LEGALIZED GAMBLING, IT PROVIDES AN UNNECESSARY INDUCEMENT FOR INDIVIDUALS TO PATRONIZE ILLEGAL BETTING OPERATIONS. ADDITIONALLY, BY DIVERTING WAGERS TO ILLEGAL OUTFITS, AND REMOVING FROM PLAY WINNINGS WHICH WOULD OTHERWISE

BE REWAGERED, WITHHOLDING FURTHER REDUCES THE FLOW OF REVENUES TO STATE AND MUNICIPAL GOVERNMENTS AND TO THE RACING INDUSTRY.

FINALLY, MR CHAIRMAN, A VERY SMALL PERCENTAGE OF INDIVIDUAL BETTORS ARE NET WINNERS FROM THEIR PARTICIPATION IN GAMBLING OPERATIONS. BY REQUIRING WITHHOLDING ON AN ONGOING BASIS, MOST OF THESE PEOPLE ARE FORCED TO SEEK A RETURN OF THEIR MONEY, AT YEAR'S END, FOR "OVER-WITHHOLDING".

IN VIEW OF THE SIGNIFICANT PROBLEMS AND MINOR BENEFITS WHICH HAVE ACCRUED AS A RESULT OF WITHHOLDING TAXES FROM PARI-MUTUEL WINNINGS, I BELIEVE THAT COMMON SENSE DICTATES WE REPEAL THIS PROVISION IN THE LAW. H.R. 2981 IS SIMPLE AND STRAIGHTFORWARD IN DOING SO AND I URGE THE COMMITTEE TO ADOPT THIS PROPOSAL.

AGAIN, MR. CHAIRMAN, AND MY COLLEAGUES, THANK YOU FOR ALLOWING ME TO APPEAR BEFORE YOU TODAY.

STATEMENT OF HON. WALTER D. HUDDLESTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY

I thank the distinguished Chairman for holding this hearing on H. R. 2981. Even though many measures this committee will consider in the next few months involve much larger amounts of money, I believe it is worthwhile to reconsider at this time the overall impact of this aspect of Internal Revenue Service policy.

I introduced S. 1369 to repeal the withholding on gambling winnings because I am convinced that the adverse effects of this withholding more than offset any increased compliance with the income tax law. I also co-sponsored a similar bill, S. 1861.

Section 3402 (q) of the Internal Revenue Code, which was added in 1976, requires that a person making payment of certain gambling winnings must deduct and withhold 20% of the payment. In determining whether winnings are subject to withholding, winnings are divided into three categories, based on the type of wagering transaction.

Wagers from horse races and other parimutuel pools are subject to a 20% withholding tax if the proceeds from the wager are over $1,000 and at least 300 times as large as the amount wagered. On the other hand, state lottery payoffs are subject to withholding only if the amount exceeds $5,000. Casino gambling has no withholding tax.

This provision was enacted with the purpose of assuring compliance with the tax laws. However, experience has demonstrated that the provision has a number of undesirable effects, and the additional degree of compliance—if any—is probably outweighed by these other considerations.

The IRS estimates that if this provision had been effective for the entire calendar year 1977, approximately $100 million would have been withheld rather than paid over to the winners.

However, this entire amount does not represent a gain to the Treasury. A study conducted by the IRS for tax year 1977 indicates that compliance rates are increased from about 68% without withholding to about 87% where the taxpayers were subject to withholding. Even assuming the IRS study to be accurate, perhaps 20% or $20 million is a revenue gain to the Treasury.

This small increased Federal revenue is more than offset by the deleterious effects of the proposal. One highly significant effect is the reduction in parimutuel revenues, which will be intensified by regulations proposed in September 1981 for aggregation of identical wagers. Reduction in parimutuel revenues means reduced purses for racing owners and also reduced revenues for state and local governments. Another significant effect is that withholding is an additional inducement for individuals to patronize illegal gambling activities whose operators do not comply with the withholding rules.

The effect on parimutuel revenues can be illustrated by examining the parimutuel wagering. Withholding at parimutuel facilities in 1980 amounted to $84 million. Statistics indicate that each dollar at a race track is rewagered on the average of 3.5 times. This removal of $84 million from the wagering stream means that approximately $294 million less is wagered because of this withholding.

Parimutuel pools are subject to a "takeout"—which generally is approximately 19% of the pool. This takeout is used for purses for the contestants, revenues for state and local governments, and amounts paid to the operator of the facility. Consequently, the reduction in wagers due to withholding means reduced revenue totaling about $56 million to state and local governments, horsemen and track operators.

These revenue reductions not only adversely affect governmental revenues in the 30 states which derive substantial revenue from parimutuel activities, but they also reduce the purses available for horsemen and other persons who participate in such sports as greyhound racing and jai alai.

These reductions not only make the horse racing industry less attractive financially, but in the long run I fear that they also will adversely affect the horse breeding industry. This fear is based on the fact that sales of thoroughbred and standardbred horses are ultimately dependent upon the potential for the horses to earn money at the track.

In many communities, the horse industry provides significant contributions to the economy. There are 350,000 people licensed to work at race tracks. Also, farms engaged in breeding horses for the race track employed about 80,000 people in 1980 to produce approximately 50,000 foals.

Furthermore, exports of horses during 1980 came to over $200 million, contributing to the vital export balances generated by American agriculture. Many of these exports result from the dominance of the U. S. blood stock industry—a dominance that could well be jeopardized by a declining horse racing industry in this country.

Because the withholding provision only applies to certain types of legalized wagers, it constitutes an additional and unnecessary inducement for individuals to engage in illegal gambling rather than legal gambling. I believe that we would all agree that the tax code should not be used to encourage or promote illegal gambling.

Furthermore, Treasury's view that there are large numbers of individuals who are not paying tax on significant amounts of winnings from parimutuel wagers is not accurate. Since approximately 19% of most parimutuel pools is subject to takeout, only about 81% of the amounts wagered are normally returned to bettors.

Under this system, it is no surprise that most bettors are net losers at the end of each year. According to a study conducted by the American Horse Council, over 85% of bettors receiving payouts subject to withholding reported that they will conclude the year as net losers in the parimutuel transactions.

For these bettors, the withholding tax becomes an excise tax on gross winnings. To obtain return of their money, they must overcome two significant hurdles. First, they must substantiate their losses under a standard which is much more strict than the standard that the IRS applies to most expenses and losses. Second, they may have to forgo the standard deduction to use the losses because the IRS allows gambling losses only as itemized deductions.

In some cases, a person may even be subject to the "alternative minimum tax" on his wagering transactions even though he can demonstrate that he has no net gambling winnings. Even if the bettor can overcome all of these obstacles and obtain the return of his money, he is still a net loser because the government has had the use of his money from the date of withholding until he receives his refund.

The bettor, at best, suffers from the inappropriate presumption in the withholding law that his winnings from a particular race, not his net winnings, are the measure of his taxable income.

Mr. Chairman, I believe that the basic strength of our tax system is voluntary compliance. Without general cooperation from taxpayers it would be impossible to generate the amount of revenue we do each year.

However, if voluntary compliance is to work, it must be based upon the perception by all taxpayers that the tax laws are fair and reasonable. I do not believe that this provision is either fair or reasonable and as a result, the real losers will be the state and local governments and the thousands of people who rely upon the racing industry for their jobs.

It seems clear to me that the adverse effects of Section 3402 (q) far outweigh the convenience to the IRS and the possible minor revenue gains to the Treasury.

March 12, 1982

Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

ATTENTION: John J. Salmon, Chief Counsel

Dear Mr. Chairman and Members of the Subcommittee:

H.R. 2981 - Repeal of Section 3402(q) of the Internal Revenue Code of 1954 which requires for income tax purposes amounts to be withheld from pari-mutuel and certain gambling winnings

I am William E. Love of Portland, Oregon. I urge your support and favorable consideration of the above captioned bill which is co-sponsored by Congressman Ron Wyden of Oregon and others. As indicated, this bill will repeal the withholding from the source of a percentage of certain so-called gambling winnings. Primarily, my concern focuses around the pari-mutuel industry--horse racing, greyhound racing, jai alai, and including off-track wagering.

While I currently am not associated with racing in any way (except as an occassional patron and fan), for some sixteen years, until 1979, I was deeply involved as a member of the Oregon Racing Commission. I also was an officer for many years of the National Association of State Racing Commissioners (NASRC) headquartered in Lexington, Kentucky, and the President of the NASRC in the late seventies. In such capacity, I appeared before the House Ways and Means Committee in opposition to the legislation allowing for such tax withholding and subsequently in favor of vitally needed amendments to make the enacted legislation administratively workable.

Others familiar with updated statistics who are associated with the many facets of racing can apprise you of the specifics as to economic and practical problems associated with the existing law. It was obvious from the beginning that the legislation would have the following effect:

1. Discourage some people from wagering. (As an aside,
his same effect will exist regarding capital investment and
avings if Congress applies the withholding mechanism to financial
nstitution interest payments and corporate dividends.)

2. Withholds from the churning and rollover action at the
rack the money actually withheld. Since the patron receives
ack less in winnings, he or she has fewer dollars to reinvest
n the wagering process.

3. The economic interests vital to racing depend largely on
he number of dollars flowing through the pari-mutuel system.
hey realize this through a percentage takeout of the wagering
andle. Tax withholding obviously has to mean less badly needed
evenue for the governing state and local governments involved,
ess purse money for the animal owners and trainers, and less
unds available for the track operators to meet ever-increasing
xpenses. In short, withholding is counterproductive all around.

hile not the issue involved, I once again want to point out to
he Committee members what I told the full Committee back in the
eventies--that actually there should not be any tax on so-called
innings arising out of pari-mutuel wagering because the system
oes not allow for there to be earned or generated any "income"
rom the economic standpoint. This distinguishes pari-mutuel
ayouts from other forms of distribution (such as interest or
ividends).

nder the system, for every one dollar paid in by the wagering
atron, somewhere between 80 to 85 cents is returned. The re-
ainder is required to pay the operating expenses, purses, state
overnmental percentages of the handle, etc. It is basically a
ooling arrangement where people throw a dollar into the pot and
ettle for 80 to 85 cents. If a person wins on one race, he or
he usually gives it back on other races over a period of time.
he few net winners in the course of any given year (and these
re few) are more than offset by the many net losers--whose net
osses CANNOT be deducted for income tax purposes. Hence, there
s and can be no net revenue impact on the Treasury.

remember one of the distinguished Committee members inquiring
hy, under such circumstances where one cannot win, people go to
he track and patronize the system, to which a colleague answered,
Because for some of us it is intriguing and a lot of fun". That
s really the correct answer.

f I can provide the Committee with any additional information,
lease let me know.

hank you.

Sincerely,

William E. Love

kaf

c: Honorable Ron Wyden

April [illegible], 1982

Leonard Repp
SUITE 401
1116 SO. NEW WILKE ROAD
ARLINGTON HEIGHTS, IL 60005

RECEIVED
APR 14 1982
WAYS AND MEANS

House Ways & Means Committee
House of Representatives
Washington, D.C. 20515

Re: Pari-Mutual Tax Repeal

Gentlemen:

In my reading of the testimoney by the Thorobred Racing Industry to a Sub-Committee of the House Ways & Means Committee, regarding the repeal of the 20% takeout on certain winning wagers no one spoke in behalf of the individual bettor, who collectively support the entire industry. I now wish to do that.

The current IRS rules regarding so-called"Windfalls" on combination bets are absurd, discriminating, and possibly un-constitutional. It is discriminating because the the large dollar bettor is completely overlooked and untouched by the IRS. The person who bets $50,000.00 on a 1-1 horse, or 4-5 horse, and wins $ 40,000.00 is not identified and consequently no 20 % takeout is made, or withheld.(I understand a certain wealthy bettor in California recently, bet $50,000.00 or more, on Perrault the winner, collecting $ 40,000.00 or more, no identification, no withholding).

We, the small bettor($150.00 daily average)who lose year after year, are identified and taxed on such small amounts as $602.00 and up . Further, we are subject to the 2½% Illinois State income tax, and further we are now subject to the self-employment tax of 10% on the gross winning wager. (I just have been billed by the IRS on a $611.00 "winner" that I overlooked) Again, the bettor who bets $1,000.00 on a 5-1 horse and wins$5,000.00 is not identified nor taxed under current rules. If he were,he would bet many small wagers so as not to be noticed by the IRS agents, totaling the $1,000.00

It is common knowledge that the regular bettor is a loser at the end of the taxable year. Those bettors who say they are winners at year-end are rightly called Liars.

The current answer to avoid paying payment or liability of taxes on "windfalls" is to stop betting on conbinations such as trifecta's,etc. I for one intend to do just that. Who needs the aggravation? The current 25% takeout is too much and confiscatory.

It is the average, regular race goer who supports racing,and it is he that is chosen to pay the taxes.Without betting,who would watch?No one would attend except the owners.Betting on the horse is the most riskiest of ventures,and special rules are needed to protect the bettor, not exploit him. He is the greatest of all suckers as it is. Would the stud fee for Northern Dancer cost $300,000.00 if there were no wagering?

However, I do have a suggestion,to placate those who say some winners on windfalls avoid taxation. I suggest imposing a 10% Federal Gambling Windfall Tax on Combination winnings of $10,000.00 or more. This tax final and not refundable.,and the gross winnings not added to your gross ordinary income. Refer to England, this is their rule on large winnings of all kinds. This would satisfy me and 99% of the bettors. We do need special rules for taxing horse betting winnings due to the extreme riskiness of losing.(I know, I went tru bankruptcy in 1980 due to horse race wagering)

The bettor who finally wins a big one shouldn't be taxed, he should be presented a shiny,golden trophy, syndicated, and his picture be placed in the Horse Bettors Hall of Fame.

CC: JOHN E. CHAPOTRON
ASS'T SEC'Y OF THE TREASURY

Sincerely,
Leonard Repp
Leonard Repp

Tax-Free Transfers of Imported Beer From Customs Custody to a Domestic Brewery

97TH CONGRESS
1ST SESSION

H. R. 1808

To amend the Internal Revenue Code of 1954 to allow certain transfers of imported beer from customs custody to a domestic brewery without payment of tax.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 6, 1981

Mr. GEPHARDT introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to allow certain transfers of imported beer from customs custody to a domestic brewery without payment of tax.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part II of subchapter G of chapter 51 of the Internal Revenue Code of 1954 (relating to operations of breweries) is amended by adding at the end thereof the following new section:

"SEC. 5418. IMPORTED BEER.

"(a) TRANSFER TO BREWERY WITHOUT PAYMENT OF TAX.—Beer imported or brought into the United States in bulk containers may, under such regulations as the Secretary shall prescribe, be withdrawn from customs custody and transferred in such bulk containers or by pipeline to a brewery without payment of the internal revenue tax imposed on such beer. The person operating the brewery to which such beer is transferred shall become liable for the tax on beer withdrawn from customs custody under this section upon release of the beer from customs custody, and the importer, or the person bringing such beer into the United States, shall thereupon be relieved of his liability for such tax.

"(b) WITHDRAWALS, ETC.—Beer transferred pursuant to subsection (a) may be withdrawn for any purpose authorized by this chapter, in the same manner as domestic beer."

(b) Paragraph (1) of section 5054(a) of such Code (relating to determination and collection of tax on beer produced in the United States) is amended to read as follows:

"(1) BEER PRODUCED IN THE UNITED STATES.—Except as provided in paragraph (3), the tax imposed by section 5051 on beer produced in the United States and on beer removed from customs custody under section 5418 shall be determined at the time it is removed for consumption or sale, and shall be paid in accordance with section 5061 by the brewer thereof (or in the case of beer so removed from customs custody, the person liable for such tax under section 5418)."

(c) The table of sections for part II of subchapter G of chapter 51 of such Code is amended by adding at the end thereof the following new item:

"Sec. 5418. Imported beer."

(d) The amendments made by this Act shall take effect on the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

Under present law, an excise tax is imposed on domestically produced beer at the time the beer is removed from the brewery for consumption or sale, and on imported beer when removed from customs custody (Code secs. 5051, 5054). The tax, which is payable by the brewer or importer, generally is $9 for each barrel containing not more than 31 gallons. A special $7-per-barrel rate applies to the first 60,000 barrels of beer produced in the United States if the brewer does not produce more than 2 million barrels of beer during the calendar year (sec. 5051(a)(2)).

In certain cases, beer can be transferred tax-free between producers and bonded warehouses before removal of the beverage for consumption or sale. For example, domestically produced beer can be transferred from one brewery to another belonging to the same brewer, and commingled with beer produced in the second brewery, without payment of tax (sec. 5414). In the case of imported beer, the excise tax is imposed at the time the beer is removed from customs custody, even if the beer is then transferred to a domestic brewery.

Issue

The issue is whether, in the case of imported beer, imposition of the beer excise tax should in certain circumstances be deferred until the beer is removed from a domestic brewery for consumption or sale.

Explanation of the bill

The bill would permit tax-free transfers of imported beer from customs custody to domestic breweries, pursuant to Treasury regulations, provided that the beer was imported or brought into the United States in bulk containers and that the beer is transferred to the breweries in bulk containers or by pipeline. In the case of such transfers, imposition of the excise tax would be deferred until the beer is removed from the brewery for consumption or sale.

Effective date

The provisions of the bill would be effective on the date of enactment.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $1 million annually.

Membership Requirements for Tax-Exempt Veterans Organizations

97TH CONGRESS
1ST SESSION

H. R. 2597

To amend the Internal Revenue Code of 1954 with respect to the exemption from tax of veterans organizations.

IN THE HOUSE OF REPRESENTATIVES

MARCH 18, 1981

Mr. JONES of Oklahoma (for himself and Mr. CONABLE) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 with respect to the exemption from tax of veterans organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (19) of section 501(c) of the Internal Revenue Code of 1954 (relating to exemption of veterans organizations) is amended—

(1) by striking out "war veterans" the first place it appears and inserting in lieu thereof "past or present members of the Armed Forces of the United States", and

(2) by amending subparagraph (B) to read as follows:

"(B) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and".

(b) The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

Under present law, a post or organization of war veterans may qualify for exemption from income tax under Code section 501(c)(19). To qualify for this exemption, (1) the organization must be organized in the United States or any of its possessions; (2) at least 75 percent of its members must be war veterans, and substantially all of the other members must be veterans, cadets, or spouses (or widows or widowers) of war veterans, veterans, or cadets; and (3) no part of the net earnings of the organization can inure to the benefit of any private shareholder or individual. For this purpose, a war veteran is any person, whether or not a present member of the Armed Forces, who served in the United States Armed Forces during a period of war (including the Korean and Vietnam conflicts).

In addition, a special exemption from the tax on unrelated business income is provided to such organization with respect to amounts received in connection with payments of life, sick, accident, or health insurance for members or their dependents, so long as the income from such activity is set aside to provide such benefits or is set aside for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals (sec. 512(a)(4)).

Issue

The issue is whether the income tax exemption for veterans organizations should be expanded to include organizations of past or present members of the U.S. Armed Forces as well as organizations of war veterans.

Explanation of the bill

The bill would amend section 501(c)(19) to provide income tax exemption for an otherwise qualifying organization of past or present members of the Armed Forces of the United States. The organization would satisfy the membership test for exemption if at least 75 percent of its members are past or present members of the U.S. Armed Forces, and if substantially all of the other members are cadets or spouses (or widows or widowers) of past or present members of the U.S. Armed Forces or of cadets.

Effective date

The provisions of the bill would be effective for taxable years beginning after the date of enactment.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

STATEMENT OF HON. BARBER B. CONABLE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

MR. CHAIRMAN, MR. DUNCAN AND MEMBERS OF THE SUBCOMMITTEE, I WANT TO THANK YOU FOR THIS OPPORTUNITY TO TESTIFY ON H.R. 2597, RELATING TO THE TAX EXEMPTION FOR CERTAIN VETERANS ORGANIZATIONS. AS THE SUBCOMMITTEE MAY RECALL, REPRESENTATIVE JONES AND I INTRODUCED THE SAME BILL LAST CONGRESS. UNFORTUNATELY, BECAUSE OF TIME LIMITATIONS, THE BILL COULD NOT BE PASSED BY THE 96TH CONGRESS. WE HAVE REINTRODUCED THE BILL BECAUSE OF OUR STRONG COMMITMENT TO PRESERVING THE TAX-EXEMPT STATUS OF MANY OF OUR VETERANS ORGANIZATIONS.

TECHNICALLY, A VETERANS ORGANIZATION IS ELIGIBLE FOR TAX-EXEMPT STATUS IF, AMONG OTHER THINGS, AT LEAST 75% OF ITS MEMBERS ARE WAR VETERANS AND SUBSTANTIALLY ALL OF ITS OTHER MEMBERS ARE VETERANS, CADETS OR SPOUSES, WIDOWS OR WIDOWERS OF WAR VETERANS.

WITH THE PASSAGE OF TIME, IT IS BECOMING INCREASINGLY DIFFICULT FOR VETERANS GROUPS TO FIND ENOUGH ELIGIBLE RECRUITS TO SATISFY THE REQUIREMENT THAT AT LEAST 75% OF ITS MEMBERS BE WAR VETERANS. SHOULD ANY ORGANIZATION NOT SATISFY THIS REQUIREMENT IT WILL LOSE ITS TAX-EXEMPT STATUS.

H.R. 2597 SEEKS TO PREVENT THIS LOSS OF TAX-EXEMPT STATUS BY PROVIDING THAT SUCH AN ORGANIZATION WILL BE TAX-EXEMPT IF AT LEAST 75% OF ITS MEMBERS ARE "... PAST OR PRESENT MEMBERS OF THE ARMED FORCES OF THE UNITED STATES..." INSTEAD OF BEING "WAR VETERANS". THIS IS ONLY A MINOR TECHNICAL CHANGE THAT WILL HAVE LITTLE, IF ANY, REVENUE IMPACT, BUT WILL PREVENT A GREAT DEAL OF HARDSHIP FOR OUR VETERANS GROUPS. I WOULD HOPE IT CAN BE PROMPTLY PASSED. THANK YOU AGAIN.

March 30, 1982

Mr. John J. Salmon
Chief Counsel
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Salmon:

We are writing you on behalf of our client, Army Mutual Aid Association, Fort Myer, Virginia.

This organization supports enactment of H.R. 2597 which would amend the membership test of Section 501(c)(19) organizations to provide tax exemption for an organization provided that at least 75% of its members are past or present members of the U. S. Armed Forces, without regard to whether or not these veterans had served during a period of war.

These organizations serve an important function and in view of the prolonged periods of peace it will eventually be impossible to have 75% of the members be war veterans. Therefore, we strongly support the deletion of the word "war" in Section 501(c)(19).

Very truly yours,

WEBSTER, CHAMBERLAIN & BEAN

By, Geo D Webster
George D. Webster

GDW:jh

STATEMENT OF MAX J. BEILKE, LEGISLATIVE COUNSEL, THE NATIONAL ASSOCIATION FOR UNIFORMED SERVICES

Mr. Chairman, and members of the subcommittee, I welcome the opportunity to present the views of the National Association for Uniformed Services to this distinguished panel.

The National Association for Uniformed Services (NAUS) is unique in that our membership represents all ranks of career and non-career service personnel and their wives and widows. Our membership includes active, retired, and reserve personnel of all seven uniformed services: Army, Navy, Air Force, Marines, Coast Guard, Public Health Service, and the National Oceanic and Atmospheric Administration. With such a membership, we are able to draw information from a broad base for our legislative activities.

Incentives to unionize our Armed Forces are drastically diminished by the existence of military and veteran associations. These associations speak effectively for active duty, retired, and veteran members on issues that affect them. They serve as a viable alternative to military unions without the element of coercion associated with union activity.

Military and veteran associations perform valuable services not only to their members, but also to members of Congress and their staffs. In 1969 Congress recognized this service and granted them tax-exempt status by adding Section 501 (c) 19 to the Internal Revenue Code of 1954. This section requires that in order to qualify for tax-exempt status, 75% of the membership must be war veterans.

Young men and women entering military service after May 7, 1975 do not qualify as war veterans. The number of living war veterans is steadily decreasing. Soon most organizations will not be able to meet the 75% war veteran membership requirement. Loss of this tax-exempt status will cause many organizations to cease to exist and thus deprive our peacetime veterans of a voice in government. All veterans, whether their service was in wartime or peacetime, deserve that voice.

NAUS strongly supports the passage of H.R. 2597.

Increase in Threshold Amount for Income Tax Withholding on Certain Gambling Winnings

97TH CONGRESS
1ST SESSION

H. R. 2647

To amend the Internal Revenue Code of 1954 to equalize the dollar amounts of income tax withholding on gambling winnings from horseracing, State-conducted lotteries, and certain other wagers.

IN THE HOUSE OF REPRESENTATIVES

MARCH 19, 1981

Mr. SCHULZE introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to equalize the dollar amounts of income tax withholding on gambling winnings from horseracing, State-conducted lotteries, and certain other wagers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (3) of section 3402(q) of the Internal Revenue Code of 1954 (defining winnings which are subject to withholding) is amended—

(1) by striking out "$1,000" in subparagraph (A) and inserting in lieu thereof "$5,000", and

(2) by striking out "$1,000" in subparagraph (C) and inserting in lieu thereof "$5,000".

(b) The amendments made by subsection (a) shall apply to payments of winnings after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

Withholding requirements

In certain circumstances, present law requires income tax to be withheld from gambling winnings at a rate of 20 percent (Code sec. 3402 (q)). The general rule is that gambling winnings are subject to withholding if the amount of proceeds from a wager exceeds $1,000 and also is at least 300 times as large as the amount wagered.[1]

Special rules apply to certain types of wagers. First, all winnings of more than $1,000 from a wager placed in a sweepstakes, wagering pool, or lottery (other than a State-conducted lottery) are subject to withholding, regardless of the amount wagered. Second, winnings of more than $5,000 from a wager placed in a State-conducted lottery are subject to withholding, and winnings of $5,000 or less from such a lottery are not subject to withholding, regardless of the amount wagered. Third, winnings from a slot machine, keno, or bingo are exempt from withholding.

If these rules require withholding, the entire amount of winnings (not merely any excess over the $1,000 or $5,000 threshold amount) is subject to withholding. If multiple wagers are placed on a single event, the winnings on each such wager are aggregated to determine whether the $1,000 or $5,000 threshold is exceeded. For example, if one $100 and two $50 wagers are placed on a single horse in a race, amounts paid on the three tickets would be added together, and the price of all three tickets would be deducted, to determine whether the winnings were subject to withholding. On the other hand, if wagers are placed by one person on different horses or on different races, the bettor's winnings from the wagers would not be aggregated for purposes of the withholding requirements.

Required information reports

Any person who is to receive a payment of gambling winnings subject to withholding must furnish the payor with a statement containing his or her name, address, and taxpayer identification (social security) number (sec. 3402(q)(6)). A payor of gambling winnings must report payments subject to withholding to the Internal Revenue Service. Where gambling winnings are less than the threshold amounts for withholding, proposed Treasury regulations would permit a payor to rely on a written statement from the recipient in determining whether multiple wagers must be aggregated and income tax withheld (Prop. Reg. § 1.6011-3).

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[1] The statute expressly applies this general rule to such proceeds from a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai.

In the case of winnings from a slot machine, keno, and bingo (which are not subject to withholding), Treasury regulations require the payor to report to the Internal Revenue Service on winnings of $1,500 or more from keno, or $1,200 or more from bingo or slot machines (Reg. § 7.6041-1).

IRS report

The Tax Reform Act of 1976, which added the withholding requirement on the ground that "many taxpayers did not report" certain gambling winnings on their tax returns,[2] also required the Internal Revenue Service to report to the tax-writing committees on the operation of the reporting system on winnings from keno, bingo, and slot machines, and to make recommendations as to whether those winnings also should be subject to withholding.[3] In a December 1980 report ("Compliance in Reporting Gambling Winnings"), the Service recommended that, "because of the significantly greater compliance demonstrated by individuals subject to withholding as compared to those subject only to information reporting," (1) withholding should be required on winnings of $1,500 or more from keno and $1,200 or more from bingo and slot machines, and (2) the withholding threshold should be lowered to $600 for horse racing, dog racing, and jai alai wagers, if the amount of proceeds from the wager is at least 300 times as large as the amount wagered, and for sweepstakes, wagering pools, and lotteries (including State-conducted lotteries).

Issue

The issue is whether the present $1,000 threshold for income tax withholding on certain gambling winnings should be increased to $5,000.

Explanation of the bill

The bill would increase to $5,000 the present $1,000 threshold amount for required income tax withholding on certain gambling winnings. As a result, income tax withholding would be required in the case of (1) proceeds exceeding $5,000 from a wagering transaction (including a wager in a parimutuel pool with respect to horse races, dog races, or jai alai) if the amount of proceeds is at least 300 times as large as the amount wagered, and (2) proceeds exceeding $5,000 from a wager placed in a sweepstakes, wagering pool, or lottery (including State-conducted lotteries), regardless of the amount wagered. As under present law, no withholding would be required for winnings from slot machines, keno, or bingo.

Effective date

The provisions of the bill would apply to payments of gambling winnings after the date of enactment.

Revenue effect

It is estimated that the bill would reduce fiscal year budget receipts by $11 million in 1982, $37 million in 1983, $11 million in 1984, $11 million in 1985, and $12 million in 1986.

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[2] House Rpt. No. 94-658, 94th Cong., 1st Sess. (1975), at 297; Senate Rpt. No. 94-938, 94th Cong., 2d Sess. (1976), at 383.

[3] House Rpt. No. 94-1515, 94th Cong., 2d Sess. (1976), at 488.

Tax Treatment of Expenses of Attending Conventions on Domestic Cruise Ships

97TH CONGRESS
1ST SESSION

H. R. 3191

To amend the Internal Revenue Code of 1954 to exempt conventions, et cetera, held on cruise ships documented under the laws of the United States from certain rules relating to foreign conventions.

IN THE HOUSE OF REPRESENTATIVES

APRIL 9, 1981

Mr. GUARINI introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to exempt conventions, et cetera, held on cruise ships documented under the laws of the United States from certain rules relating to foreign conventions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (2) of section 274(h) of the Internal Revenue Code of 1954 (relating to attendance at conventions, et cetera) is amended to read as follows:

"(2) CONVENTIONS ON CRUISE SHIPS.—

"(A) FOREIGN CRUISE SHIPS.—In the case of an individual who attends a convention, seminar, or other meeting which is held on any cruise ship which is not a domestic cruise ship, no deduction shall be allowed under section 162 or 212 for expenses allocable to such meeting.

"(B) DOMESTIC CRUISE SHIPS.—A convention, seminar, or similar meeting held on a cruise of a domestic cruise ship shall be treated as held in the North American area if all ports of call of such cruise are inside the North American area."

(b) Paragraph (3) of section 274(h) of such Code is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

"(B) DOMESTIC CRUISE SHIP.—The term 'domestic cruise ship' means any cruise ship documented under the laws of the United States."

(c) The amendments made by this Act shall apply to conventions, seminars, and meetings beginning after December 31, 1981.

SUMMARY AND DESCRIPTION

Present law

In general

Under present law, a deduction is allowed for the ordinary and necessary expenses of carrying on a trade or business or income-producing activity (Code secs. 162, 212), including transportation expenses and amounts for meals and lodging while away from home in pursuit of a trade or business or income-producing activity. Transportation expenses are deductible if the principal purpose of the trip is for business purposes. Meals and lodging expenses (other than lavish and extravagant expenditures) are deductible if they are allocable to a business purpose. Generally, therefore, a deduction is allowed for the cost of attending a convention or seminar in pursuit of a trade or business or income-producing activity.

Special rules (sec. 274(h)) are provided for travel expenses for attendance at conventions, seminars, or similar meetings if held outside the United States, its possessions, Canada, Mexico, or the Trust Territory of the Pacific Islands (the "North American area") [1] or if held on a cruise ship. (Conventions, etc. held outside the North American area are commonly referred to as "foreign conventions".) The section 274(h) rules apply both to expenses paid by individuals attending such conventions and also to expenses paid by employers of such individuals.

Under section 274(h)(1), no deduction is allowed for the expenses of attending a foreign convention unless, taking certain factors into account, it is as reasonable to hold the meeting outside the North American area as within it. Under section 274(h)(2), no deduction is allowed for the expenses of attending any convention, etc. held on a cruise ship, even if the ship is sailing entirely within U.S. territorial waters.

Background

Special rules for foreign conventions were first enacted in 1976 because of the proliferation of foreign conventions, seminars, and cruises that were ostensibly held for business or educational purposes, but which appeared to the Congress to be vacations in disguise. Under pre-1976 law, the allowance of deductions for such trips depended on a subjective determination of the taxpayer's principal purpose in making the trip. This had proved to be a difficult standard for the Internal Revenue Service to apply, particularly in the case of overseas trips.

Under the rules as initially adopted in 1976, deductions could be taken for no more than two foreign conventions per year, and were limited to certain transportation and subsistence expenses. However, the 1976 rules proved to be unsatisfactory because, in addition to imposing burdensome reporting requirements, those rules in some cases operated to disallow legitimate business travel expenses while in other cases failed to disallow deductions for trips which actually were foreign vacations.[2]

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[1] Under the United States-Jamaica income tax treaty, deductions are permitted for expenses of attending a convention in Jamaica (Art. 25(7)). Thus, Jamaica is, in effect, treated for this purpose as within the North American area.

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[2] Sen. Rept. No. 96-1031, 96th Cong., 2d Sess. (1980), at p. 12.

Accordingly, the rules were revised by the Congress in 1980 (P.L. 96-608). The present "as reasonable" rule was intended to focus on the reason why a foreign site was selected for the convention or meeting. The disallowance of deductions for expenses of attending conventions, etc. on cruise ships was justified on the ground that the personal benefits of going on a cruise often predominate over business purposes. Therefore, it was argued, disallowing deductions for such expenses avoids disputes on audit and prevents taxpayers from claiming deductions that would not be upheld by a court. On the other hand, it was argued that denying deductions for conventions held on all cruise ships would disadvantage the U.S. cruise ship industry.

Issue

The issue is whether the expenses of attending a convention, seminar, or similar meeting held on a cruise of a U.S. cruise ship should be deductible if all the ports of call of the cruise are within the North American area.

Explanation of the bill

Under the bill, a convention, seminar, or similar meeting held on a cruise of a domestic cruise ship would be treated as held in the North American area if all the ports of call of the cruise are within the North American area. Thus, business expenses for attending such a meeting would be treated the same as other business expenses. For example, transportation expenses would be deductible if the principal purpose of the trip is for business, and meals and lodging expenses would be deductible to the extent they are allocable to a business purpose and are not lavish or extravagant. A domestic cruise ship would be defined as a cruise ship documented under the laws of the United States.

Under the bill, no deduction would be allowed for expenses of attending a convention, seminar, or other meeting held on a cruise ship which is not a domestic cruise ship.

Effective date

The amendments made by the bill would apply to expenses allocable to conventions, seminars, and meetings beginning after December 31, 1981.

Revenue effect

It is estimated that the bill would have a negligible effect on budget receipts.

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March 29, 1982

The Honorable Fortney H. Stark
Chairman
Subcommittee on Select Revenue Measures
C/O John J. Salmon, Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Stark:

Re: H.R. 3191
Hearings--March 16, 1982

This statement is written on behalf of the Government of Bermuda* and relates to H.R. 3191 introduced by Mr. Guarini on the deductibility of expenses incurred in attending foreign conventions.

Bermuda has testified often before the House Ways and Means Commmittee to seek an exemption from the provisions set forth in section 274(h) of the Code. Bermuda submits that the equities and Bermuda's close relationship with the United States justify an exemption such as that now provided to Canada, Mexico and Jamaica. Bermuda also notes that it is not included within the Administration's current Caribbean Basin Initiative submitted to Congress on March 17, 1982. Bermuda supports the Administration's Initiative and the United States effort to establish closer relationships with Caribbean Island and Central American countries. Since Bermuda does not lie in the Caribbean, Bermuda is not included, but Bermuda does stress its continual close relationship with the United States. Bermuda asks that it be included as a country within the North American exemption set forth in section 274(h).

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*Ragan & Mason is registered with the Department of Justice and under the Foreign Agent Registration Act, 22 U.S.C. §611, et. seq. as an agent for the Government of Bermuda. Registration does not represent approval by the United States Government of statements made herein.

Although Bermuda has less than 57,000 people and is less than 21 square miles in land mass, approximately 10 percent of Bermuda's total area has been under United States flag for the past 40 years. The United States pays no rent for such land which has an active United States naval base thereon. Bermuda has always maintained a stable political and economic environment, and it is in the mutual best interests of both the United States and Bermuda that this be maintained.

Bermuda is primarily reliant upon its tourist industry for revenue. In the past more than 85 percent of all regular visitors have accounted for 90 percent of all receipts from regular visitors. Prior to the enactment of the foreign convention rules in 1976, there was a consistent pattern that 30 percent of Bermuda's regular visitors came in convention groups. To date Bermuda has been able to document that over 118 conventions, large and small, originating from the United States, have been cancelled. The loss in room night revenues alone from these conventions has amounted to more than $21,000,000.

Recent indications are that the tourist industry in Bermuda is suffering. Although these difficulties arise in part due to current economic conditions, it is believed that many of these difficulties can be overcome if Bermuda were included in the North American exemption. Tourist levels in Bermuda in 1981 slumped to the lowest level since 1975. Projections for the first quarter of 1982 show further declines than that experienced in 1981. Compared with 1980, Bermuda experienced in 1981 the following:

1. More than a 12 percent decrease in regular and crew ship visitors;
2. A shortfall of 61,000 tourists;
3. Room occupancies declined by almost 17 percent;
4. Visitors from the United States were down 11.5 percent; and
5. Crew ship business fell by 10.6 percent.

For the first quarter in 1982, it has been estimated that a further slump of 31 percent over the first quarter of 1981 is expected.

Bermuda, of course, supports the inclusion of Canada, Mexico and Jamaica within the North American exemption provisions. However, Bermuda believes the equities and the close relationship of Bermuda to the United States require that the United States Congress enact legislation to include Bermuda within this exemption. This, with little, if any, financial impact on the United States, would greatly assist Bermuda's primary industry and would continue the close and dynamic relationship which exists between the two countries. Such action would be totally consistent with the Administration's Caribbean Basin Initiative to offer assistance to close neighbors of the United States. Not being part of this Initiative, being included in the "North American exemption" provision of Section 274(h) of the Code would put Bermuda in an equitable position. Your consideration of these remarks is appreciated.

Very truly yours,

RAGAN & MASON

Ragan

William F. Ragan

International Organization of
Masters, Mates & Pilots
39 Broadway, New York, N.Y. 10006/(212) 425-3860/Cable: BRIDGEDECK/Telex No.: 12-5858

ROBERT J. LOWEN
International President
ALLEN C. SCOTT
International Executive Vice President
LLOYD M. MARTIN
International Secretary-Treasurer

March 29, 1982

The Honorable Fortney Stark, Chairman
Subcommittee on Select Revenue Measures
Committee on Ways and Means
1136 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The International Organization of Masters, Mates & Pilots, ILA, AFL-CIO, strongly supports H.R. 3191 "to exempt conventions held on cruise ships documented under the laws of the United States from certain rules relating to foreign conventions." This legislation would allow expenses associated with attending such conventions and meetings on American cruise ships to be deducted as business expenses.

H.R. 3191 properly recognizes that American vessels are an extension of the territory of the Unites States. Meetings, conventions or seminars held aboard a United States-flag vessel should be treated the same as those held within the United States itself. Similarly, American taxpayers who attend such meetings should be afforded the same rights and benefits under the Internal Revenue Code as those citizens who meet in domestic land-based facilities.

By retaining the general prohibition against deductions for meetings held outside the United States and on foreign-flag vessels, H.R. 3191 will treat the American maritime industry like every other industry under its scope. Equally important, eliminating the discrimination against United States-flag vessels will achieve many other important economic benefits. The greater use of American vessels will generate job opportunities for American seafaring labor and American workers in related service and supply industries. These vessels will undergo periodic maintenance and repairs and such work will be performed in American shipyards. The operation of these vessels will necessitate the purchase of goods and services from virtually every other sector of the American economy.

We therefore strongly urge that H.R. 3191 be enacted so as to permit the deduction of expenses for conventions held on vessels documented under the laws of the United States. This will continue the progress made by the government and all segments of the maritime industry to revitalize the United States-flag passenger fleet.

We will be pleased to provide you with any additional information, if you so desire.

We request that this statement be made part of the hearing record on H.R. 3191.

Sincerely,

Robert J. Lowen
President

RJL:las

Exclusion of Research Expenses From Capital Expenditure Limitation for Small Issue Industrial Development Bonds

97TH CONGRESS
1ST SESSION

H. R. 4444

To amend the Internal Revenue Code of 1954 with respect to the treatment of research or experimental expenditures for purposes of the small issue exemption from the industrial development bond rules.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 9, 1981

Mr. SHANNON introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 with respect to the treatment of research or experimental expenditures for purposes of the small issue exemption from the industrial development bond rules.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (6) of section 103(b) of the Internal Revenue Code of 1954 (relating to exemption for certain small issues) is amended by adding at the end thereof the following new subparagraph:

"(K) RESEARCH OF EXPERIMENTAL EXPENDITURES NOT TAKEN INTO ACCOUNT.—For purposes of applying subparagraph (D)(ii), research or experimental expenditures which are treated as expenses not chargeable to capital account pursuant to section 174(a) shall not be taken into account."

(b) The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

In general

Interest on State and local government obligations generally is exempt from Federal income tax (Code sec. 103(a)). However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable (sec. 103 (b)). An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

Present law provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds (sec. 103(b)(6)). This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects for which the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of an exempt small issue) made over a six-year period[1] does not exceed $10 million. (The combined issue amount and capital expenditure limitation of $10 million has the effect of precluding availability of an interest exemption where industrial development bonds would have a face amount not exceeding the $10 million limitation, but would be used in connection with large scale, high cost projects.) Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

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[1] The relevant six-year period is the period beginning three years before the date of the issue and ending three years after that date.

Under Treasury regulations, expenditures are treated as capital expenditures for purposes of the $10 million limitation if they are properly chargeable to the capital account of any person or State or local governmental unit. This determination is to be made without regard to any rule of the Code that permits expenditures properly chargeable to capital account to be treated as current expenses (Reg. § 1.103–10(b)(2)(ii)(e)).

Treatment of research expenditures

As a general rule, business expenditures to develop or create an asset which has a useful life that extends substantially beyond the taxable year must be capitalized and cannot be fully deducted in the year paid or incurred. For example, research expenditures to develop a new consumer product must be capitalized, because such expenditures relate to an asset which will have a useful life exceeding one year. Such capital costs usually may be recovered on a disposition or abandonment of the asset, or through depreciation or amortization deductions over the useful life of the asset.

However, present law permits a taxpayer to elect to deduct currently the amount of research or experimental expenditures incurred in connection with the taxpayer's trade or business, even if such expenses are treated as capital account charges or deferred expenses on the taxpayer's books or financial statements (sec. 174(a); Rev. Rul. 58–78, 1958–1 C.B. 148). In the case of research expenditures resulting in property which does not have a determinable useful life (such as secret processes or formulae), the taxpayer alternatively may elect to deduct the costs ratably over a period of not less than 60 months (sec. 174(b)).[3]

Because research or experimental expenditures constitute capital expenditures, such expenses are taken into account under present law for purposes of determining if the exempt small issue limitation of $10 million is exceeded, whether or not the taxpayer elects to deduct research expenses currently (Rev. Rul. 77–27, 1977–1 C.B. 23).

In addition to the favorable treatment provided under Code section 174 for deduction of research expenditures, the Economic Recovery Tax Act of 1981 provides a 25-percent tax credit for certain research and experimental expenditures paid in carrying on a trade or business of the taxpayer to the extent exceeding the amount of such expenditures during a base period (Code sec. 44F).

Issue

The issue is whether research or experimental expenditures should be counted toward the $10 million limitation for exemption of interest on small issue industrial development bonds.

Explanation of the bill

Under the bill, research or experimental expenditures which the taxpayer elects to deduct currently under section 174(a) would not be taken into account for purposes of the $10 million limitation on small issue industrial development bonds.

Effective date

The provisions of the bill would apply to obligations issued after the date of enactment.

Revenue effect

It is estimated that the bill would reduce fiscal year budget receipts by $2 million in 1983, $8 million in 1984, $14 million in 1985, $20 million in 1986, and $27 million in 1987.

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[3] If expenditures relating to development of a product are not eligible for these elections, or if the taxpayer chooses not to elect either current deductions or amortization for qualifying research costs, such expenditures must be capitalized. If the capitalized expenses relate to depreciable property, deductions may be taken in the form of depreciation allowances spread over the property's useful life. If the capitalized expenses relate to nondepreciable property, those costs cannot be recovered until disposition or abandonment of the property.

Rollovers of Partial Distributions Under Qualified Plans and Tax-Sheltered Annuities

97TH CONGRESS
1ST SESSION

H. R. 4473

To amend the Internal Revenue Code of 1954 to permit the rollover to individual retirement plans of certain partial distributions received by employees.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 15, 1981

Mr. BRODHEAD introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to permit the rollover to individual retirement plans of certain partial distributions received by employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. ROLLOVER OF PARTIAL DISTRIBUTIONS.

(a) GENERAL RULE.—

(1) QUALIFIED TRUSTS.—Clause (i) of section 402(a)(5)(A) of the Internal Revenue Code of 1954 (relating to rollover amounts) is amended to read as follows:

"(i) any portion of the balance to the credit of an employee in a qualified trust is paid to him,".

(2) QUALIFIED ANNUITIES.—Clause (i) of section 403(a)(4)(A) of such Code (relating to rollover amounts) is amended to read as follows:

"(i) any portion of the balance to the credit of an employee in an employee annuity described in paragraph (1) is paid to him,".

(3) SECTION 403(b) ANNUITIES.—Clause (i) of section 403(b)(8)(A) of such Code (relating to rollover amounts) is amended to read as follows:

"(i) any portion of the balance to the credit of an employee in an annuity contract described in paragraph (1) is paid to him,".

(b) SPECIAL RULES FOR ROLLOVERS OF PARTIAL DISTRIBUTIONS.—Paragraph (5) of section 402(a) of such Code is amended by redesignating subparagraphs (D) and (E) as subparagraphs (E) and (F), respectively, and by inserting after subparagraph (C) the following new subparagraph:

"(D) SPECIAL RULES FOR PARTIAL DISTRIBUTIONS.—

"(i) REQUIREMENTS.—Subparagraph (A) shall apply to a partial distribution only if—

"(I) such distribution is received by the employee after separation from the service,

"(II) such distribution is not one of a series of periodic payments for a period determined in whole or in part by reference to life of employee, and

"(III) the employee elects (at such time and in such manner as the Secretary shall by regulations prescribe) to have subparagraph (A) apply to such partial distribution.

"(ii) PARTIAL DISTRIBUTIONS MAY BE TRANSFERRED ONLY TO INDIVIDUAL RETIREMENT PLANS.—In the case of a partial distribution, a plan described in subclause (IV) or (V) of subparagraph (E)(iv) shall not be treated as an eligible retirement plan.

"(iii) DENIAL OF 10-YEAR AVERAGING AND CAPITAL GAINS TREATMENT FOR SUBSEQUENT DISTRIBUTIONS.—If an election under clause (i) is made with respect to any partial distribution paid to any employee—

"(I) paragraph (2) of this subsection,

"(II) paragraphs (1) and (3) of subsection (e), and

"(III) paragraph (3) of section 403(a),

shall not apply to any distribution (paid after such partial distribution) of the balance to the credit of such employee under the plan under which such partial distribution was made (or under any other plan which, under subsection (e)(4)(C), would be aggregated with such plan).

"(iv) SPECIAL RULE FOR UNREALIZED APPRECIATION.—If an election under clause (i) is made with respect to any partial distribution, the second and third sentences of paragraph (1) shall not apply to such distribution.

"(v) SELF-EMPLOYED INDIVIDUALS.—Subparagraph (A) shall not apply to a partial distribution if any part of the distribution is attributable to a trust forming part of a plan under which the employee was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan."

(c) PARTIAL DISTRIBUTIONS PAID TO SPOUSE OF EMPLOYEE AFTER EMPLOYEE'S DEATH ELIGIBLE FOR ROLLOVER.—

(1) IN GENERAL.—Paragraph (7) of section 402(a) of such Code (relating to rollover where spouse receives lump-sum distribution at death of employee) is amended to read as follows:

"(7) ROLLOVER WHERE SPOUSE RECEIVES DISTRIBUTIONS AFTER DEATH OF EMPLOYEE.—If any distribution attributable to an employee is paid to the spouse of the employee after the employee's death, paragraph (5) shall apply to such distribution in the same manner as if the spouse were the employee."

(2) ESTATE TAX TREATMENT.—Subsection (e) of section 2039 of such Code (relating to exclusion of individual retirement accounts, etc.) is amended by striking out "section 402(a)(5)" and inserting in lieu thereof "section 402(a)(5) (without regard to section 402(a)(7))".

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The following provisions are each amended by striking out "qualifying rollover distribution" each place it appears and inserting in lieu thereof "qualified total distribution":

(A) section 402(a)(5)(B) of such Code,

(B) section 402(a)(5)(E)(i) of such Code (as redesignated by subsection (b)), and

(C) section 402(a)(6)(E)(i) of such Code.

(2) Subparagraph (B) of section 402(a)(5) of such Code is amended by adding at the end thereof the following new sentence: "In the case of any partial distribution, the maximum amount transferred to which subparagraph (A) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to this paragraph)."

(3) Clause (ii) of section 402(a)(5)(E) (as redesignated by subsection (b)) is amended by striking out "gross income" and inserting in lieu thereof "gross income (determined without regard to this paragraph)".

(4) Subparagraph (E) of section 402(a)(5) of such Code (as redesignated by subsection (b)) is amended by adding at the end thereof the following new clause:

"(v) PARTIAL DISTRIBUTION.—The term 'partial distribution' means any distribution to an employee of any portion of the balance to the credit of such employee in a qualified trust; except that such term shall not include any distribution which is a qualified total distribution."

(5) Subparagraph (F) of section 402(a)(5) of such Code (as redesignated by subsection (b)) is amended by striking out "subparagraph (D)(iv)" each place it appears and inserting in lieu thereof "subparagraph (E)(iv)".

(6) Paragraph (6) of section 402(a) of such Code is amended by striking out "paragraph (5)(D)(i)" each place it appears and inserting in lieu thereof "paragraph (5)(E)(i)".

(7) Clauses (iii) and (iv) of section 402(a)(6)(D) of such Code are each amended by striking out "employee contributions" and inserting in lieu thereof "employee contributions (or, in the case of a partial distribution, the amount not includible in gross income)".

(8) Clause (i) of section 402(a)(6)(E) of such Code is amended by striking out "paragraph (5)(D)(i)(II)" and inserting in lieu thereof "paragraph (5)(E)(i)(II)".

(9) Subparagraph (B) of section 403(a)(4) of such Code is amended by striking out "(B) through (E)" and inserting in lieu thereof "(B) through (F)".

(10) Subparagraph (B) of section 403(b)(8) of such Code is amended to read as follows:

"(B) SPECIAL RULES FOR PARTIAL DISTRIBUTIONS.—

"(i) IN GENERAL.—In the case of any distribution other than a total distribution, rules similar to the rules of clauses (i) and (ii) of section 402(a)(5)(D) shall apply.

"(ii) TOTAL DISTRIBUTION.—For purposes of subparagraph (A), the term 'total distribution' means one or more distributions from an annuity contract described in paragraph (1) which would constitute a lump-sum distribution within the meaning of section 402(e)(4)(A) (determined without regard to subparagraphs (B) and (H) of section 402(e)(4)) if such annuity contract were described in subsection (a).

"(iii) AGGREGATION OF ANNUITY CONTRACTS.—For purposes of this paragraph, all annuity contracts described in paragraph (1) purchased by an employer shall be treated as a single contract, and section 402(e)(4)(C) shall not apply."

(11) Subparagraph (C) of section 403(b)(8) of such Code is amended by striking out "(E)(i)" and inserting in lieu thereof "(F)(i)".

(12) Clause (ii) of section 408(d)(3)(A) of such Code is amended by striking out "rollover contribution from an employee's trust" and inserting in lieu thereof "rollover contribution of a qualified total distribution (as defined in section 402(a)(5)(E)(i)) from an employee's trust".

(13) Subparagraph (C) of section 409(b)(3) of such Code is amended by striking out the second sentence and inserting in lieu thereof the following new sentences: "This subparagraph does not apply in the case of a transfer to such an employees' trust or such an annuity unless no part of the value of such proceeds is attributable to any source other than a qualified rollover contribution. For purposes of the preceding sentence, the term 'qualified rollover contribution' means any rollover contribution of a qualified total distribution (as defined in section 402(a)(5)(E)(i)) which is from such an employees' trust or annuity plan (other than an annuity plan or a trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under such plan), and which

did not qualify as a rollover contribution by reason of section 402(a)(7)."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to distributions made after December 31, 1981, in taxable years ending after such date.

(2) TRANSITIONAL RULE.—For purposes of applying the amendments made by this section to partial distributions made after December 31, 1981, and before the date of the enactment of this Act, the period specified in section 402(a)(5)(C) of the Internal Revenue Code of 1954 shall not expire before the date 180 days after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

Present law

In general

If a lump sum distribution is paid to an employee (or the spouse of a deceased employee) under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over to another qualified plan or to an IRA (an individual retirement account, individual retirement annuity, or retirement bond). Tax-free rollovers are also provided for certain distributions from terminated qualified pension, etc. plans. In addition, certain total distributions under a tax-sheltered annuity contract may be rolled over, tax-free, to another such contract or to an IRA. Tax-sheltered annuity contracts (including custodial accounts investing in shares of a regulated investment company) may be purchased for employees by certain tax-exempt organizations or by public educational organizations.

The tax deferral provided for distributions from qualified plans and tax-sheltered annuity programs (Code secs. 402 and 403) applies only if rollover contribution to an IRA, etc. is made within 60 days after the distribution is received.

Lump sum distributions

A distribution from a qualified plan is a lump sum distribution only if it consists of the balance to the credit of the employee under the plan, is made within one taxable year of the recipient, and is made on account of the employee's separation from service[1] or death, or after the employee attains age 59½.[2]

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[1] In the case of a self-employed individual, the separation-from-service test does not apply. A distribution to a self-employed individual who has become disabled may, however, qualify as a lump sum distribution.

[2] In addition to qualifying for rollover treatment, a lump sum distribution under a qualified plan is accorded special income tax treatment under which all or a portion of the distribution may be taxable to the recipient as long-term capital gain or under a 10-year forward income averaging formula. Also, under the qualified plan rules, all or a portion of the unrealized appreciation in employer securities included in a distribution is excluded from gross income for the taxable year of the distribution.

If an employer maintains more than one qualified plan of the same type, the plans generally are aggregated for the purpose of determining whether the balance to the credit of the employee has been distributed. For example, all profit-sharing plans maintained by the employer are treated as a single plan.

In the case of tax-sheltered annuities, the aggregation rules provide that all annuity contracts purchased for an employee by one employer are treated as a single contract.

Plan termination distributions

A distribution from a qualified plan is also eligible for rollover treatment if it constitutes the balance to the credit of the employee under the plan and is paid to the recipient within one taxable year on account of termination of the plan, or, in the case of a profit-sharing or stock bonus plan, on account of a complete discontinuance of contributions under the plan.

Issues

The issue is whether a distribution which is not a lump sum distribution or a termination distribution should be eligible for tax-free rollover treatment.

Explanation of the bill

Under the bill, a partial distribution under a qualified plan or a tax-sheltered annuity could be rolled over, tax-free, to an IRA if paid to an employee who has separated from the service of the employer or to the surviving spouse of a deceased employee. A partial distribution is any distribution, other than a payment under a life annuity, which is neither a lump sum distribution nor a total distribution on account of termination of a qualified plan.

Only the portion of a partial distribution otherwise includible in the recipient's gross income could be included in the rollover contribution under the bill. Accordingly, amounts included in a partial distribution which are excluded from the recipient's income as a return of the employee's nondeductible contributions under the distributing plan could not be transferred to an IRA.

Under the bill, in the case of a partial distribution, the income exclusion [illegible] rollover contributions would apply only if the taxpayer so elects. [illegible] income exclusion were elected, subsequent distributions made [illegible] to the employee under the plan (or a plan of the same [illegible] maintained by the employer) could qualify for tax-free rollover [illegible] to an IRA, but would not otherwise be accorded the special [illegible] treatment provided for lump sum distributions. In addition, [illegible] distribution is the subject of a rollover, the income exclusion [illegible] appreciation in employer securities would not apply [illegible] securities included in the distribution.

Under [illegible], a partial distribution paid to an employee would not be eligible for tax-free rollover treatment if any portion of the distribution were attributable to contributions made on behalf of the employee while the employee was a self-employed individual.

Effective date

The provisions of the bill generally would apply to distributions made after December 31, 1981, in taxable years ending after such date. Under a transitional rule, the 60-day period within which a rollover contribution must be made would not expire until 180 days after enactment.

Revenue effect

It is estimated that the bill would have a negligible effect on budget receipts.

STATEMENT OF HON. WILLIAM M. BRODHEAD, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. Chairman, thank you for including H.R. 4473 among the measures to be considered at this hearing. I introduced this bill, which is completely noncontroversial to the best of my knowledge, in response to a problem encountered by my constituent, Mr. Henry Faigin of Detroit. H.R. 4473 would enable a worker to make a partial rollover of funds from a tax-qualified pension plan or tax-sheltered annuity program to an Individual Retirement Account (IRA) without incurring any tax liability. In establishing this additional retirement-planning option, the bill eliminates restrictions in the Employee Retirement Income Security Act (ERISA) which time has shown to be unnecessary and burdensome.

To illustrate this final point, let me explain briefly how the restriction in current law which now prevents partial rollovers came to exist. As originally enacted, ERISA permitted tax-free rollovers of benefits paid by tax-qualified plans only in those cases where the benefits could otherwise be subject to special 10-year income-averaging treatment. Accordingly, rollovers are generally available only where an employee receives a distribution of the full balance of benefits under a plan in a single taxable year. Tax-free rollover treatment was later extended to employee benefits under tax-sheltered annuity programs.

The requirement that the full balance be received in a single year can be justified as a condition of eligibility for 10-year income averaging because it prevents an individual, by opting to receive his balance gradually, from gaining the benefit of income averaging over a longer period of time. However, this restriction is completely unnecessary where the taxpayer is merely transferring benefits under a qualified plan or a tax-sheltered annuity program to an Individual Retirement Account. Moreover, the restriction interferes with a worker's ability to plan for retirement. For example, it may prevent a worker from diversifying investments to suit individual needs by leaving part of the funds in a plan and transferring part to an IRA where earnings rates may be higher or where the funds will be more easily accessible.

While providing the flexibility to make a partial rollover, H.R. 4473 also contains several safeguards to prevent this option from being abused. First, partial rollovers could be made only in cases where an individual has left a job. This will ensure that no employee is encouraged by this change in the rollover rules to accelerate withdrawal of funds from his employer's retirement program. Second, partial rollovers could not be made using regular annuity payments which are part of a life annuity. If regular annuity payments could be rolled over, the tax on this retirement income would be changed from an income tax to a consumption tax. H.R. 4473 will also prevent a compounding of tax benefits by barring 10-year income averaging, capital gains treatment, and deferral of tax on unrealized appreciation in employer stock where a partial rollover has been made.

In closing, Mr. Chairman, H.R. 4473 provides workers with retirement planning flexibility which is both logical and fair. The bill is fully consistent with the principles incorporated in ERISA and in existing tax law. Its revenue effect is estimated by the Joint Committee on Taxation to be negligible. I urge that it be approved by the Subcommittee.

STATEMENT OF HENRY FAIGIN, DETROIT, MICHIGAN

In August 1974 I ret~~urned~~ired from my position as a High School Social Studies teacher at Pershing High in Detroit. At that time, I had contributed about $30,440.00 to a tax sheltered account with the Variable Annuity Life Insurance Company of Houston, Texas. I, therefore, became ineligible to add to this account but continued to earn 4% annual interest.

In December 1977 when we sold our house, I decided to withdraw about $4,400.00 from my Variable Account and deposit it with most of my other money to a total of $30,000 in six year savings certificates with First Federal Savings at about 8% annual interest.

A little while later various rollover plans started, and I wanted to liquidate my $26,000 variable account and roll it over in a lump sum to an IRA plan.

I called tne IRS several times and got conflicting advice. One day an official would tell me I could do it tax free, another day I was told I would have to pay full income tax on it.

I wrote to Washington and while I could not fully understand the answer, it seemed to me they were telling me I would have to pay a full tax on the $26,000 as part of my income.

I then contacted Congressman Brodhead's office and their research resulted in H.R. 4473.

Now I am approaching my 70th birthday and as I understand it even if I could rollover now I would have to start withdrawing within six months and pay income tax on the withdrawals.

I would be glad to give any further testimony that would be helpful.

STATEMENT OF JEFF R. HART, APPWP, INC., THE NATIONAL ASSOCIATION FOR EMPLOYEE BENEFITS

The Association of Private Pension and Welfare Plans (APPWP) is filing this written testimony in support of H.R. 4473, introduced by Congressman Brodhead on September 15, 1981. H.R. 4473 would amend the Internal Revenue Code to permit employees to "rollover" certain partial distributions from pension, profit-sharing, stock bonus, and annuity plans into individual retirement arrangements (IRA's) without the payment of current tax.

The APPWP is comprised of about 600 members across the United States, approximately one-half of which sponsor plans while others are service firms to the private pension sector, such as banks, insurance companies, accounting firms, actuarial consultants, investment counselors, etc. Thus, we represent a broad spectrum of organizations who have instituted part of the private pension system in this country or assist in servicing its needs.

Our Association strongly supports H.R. 4473 and commends Congressman Brodhead for introducing this bill. We believe that the bill represents a much needed first step in simplifying one of the most complex areas of the tax law and promoting additional private savings for retirement.

At present, tax-free rollovers of distributions from qualified plans to other qualified plans or IRA's generally are available only if the individual receives the full balance to his credit under the plan within one taxable year. This "full balance" requirement may be justified as a prerequisite to eligibility for special ten-year averaging because it limits the availability of the special tax treatment and assures that only those distributions where a "bunching of income" exists will be eligible for such treatment.

However, where an individual receives a distribution from a qualified plan and wishes to transfer such amount to another qualified plan or IRA, the policy of requiring a distribution of the "full balance" is unnecessary. The purpose of the rollover provision is to facilitate portability and permit an individual the flexibility to structure his investments in a manner which satisfies his needs.

H.R. 4473 would permit an individual to rollover, without tax, certain partial distributions from a retirement plan qualified under Code §401(a) or annuity within Code §403(a) and (b) if such distributions are transferred to an IRA within sixty days of distribution. It would not alter the various rules applicable to rollovers of total distributions.

We believe that this liberalization is a step in the right direction but in the interest of expanding the concept of portability and developing a simplified set of rollover rules, we believe that the rules should be liberalized even further. Indeed, we suggest that an individual be permitted to rollover, without tax, distributions from any qualified retirement plan, tax-sheltered annuity, or individual retirement plan (*i.e.*, an IRA, individual retirement annuity, or retirement bond) to any other qualified plan, tax-sheltered annuity, or individual retirement plan so long as the amounts remain subject to at least the same statutory restrictions that were applicable before the rollover.

For example, under current law an individual who maintains an IRA is unable to rollover the amount in his IRA into a qualified plan without subjecting the distribution to certain penalty and income taxes. Because of the deduction for retirement savings in the Economic Recovery Tax Act of 1981, qualified plans may be amended to accept deductible employee contributions and hold such amounts subject to restrictions similar to the IRA. If an employer is willing to amend its plan to adopt identical restrictions to the IRA, the employee should be permitted to rollover without tax his IRA account balance into the qualified plan. Moreover, an individual should not be prohibited, as under current law, from rolling over amounts in an H.R. 20 plan to a corporate plan or an IRA as long as the amounts remain subject to the H.R. 10 rules. Such transfers would permit a participant to consolidate his retirement resources, thereby reducing expenses and providing additional resources for his subsequent retirement. So long as the vehicle to which the participant is rolling over is subject to at least the same statutory restrictions as the vehicle from which he received the distribution, there is no abuse by such rollover.

The Honorable John E. Chapoton in his testimony given before this Committee on March 16, 1982, mentioned that rollover treatment for partial distributions should be extended to partial distributions received not only after separation from service, but also after a plan termination, a discontinuance of plan contributions, or the sale of a corporate subsidiary or assets. We concur with Mr. Chapoton's suggestion, but suggest that, in addition, rollover treatment be extended to any partial distribution received at such time as the individual could have received a "lump sum distribution" under section 402(e)(A). This would mean, for example, that an individual could rollover any partial distributions received after age 59-1/2, even though he has not yet separated from service.

In conclusion, we support H.R. 4473 as an appropriate step in the liberalization and simplification of the rollover rules. We suggest, however, that H.R. 4473 be amended in the ways discussed above to liberalize the rollover rules further. Such amendments would be an appropriate way in which to bring the technical rules into full alignment with the retirement policies underlying qualified plans and individual retirement arrangements.

March 29, 1982

The Honorable Fortney H. Stark, Chairman
Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
1034 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 4473

Dear Mr. Chairman:

This statement for the record of your hearings on H.R. 4473 is submitted on behalf of The ERISA Industry Committee (ERIC), an organization of some one hundred major employers which maintain qualified retirement plans for the benefit of their employees.

The bill would amend the Code to permit employees upon termination of employment to "roll over" to IRAs on a tax-free basis less than all of their accrued benefits under a qualified plan. Under current law, an employee may only "roll over" a distribution of the total amount of his accrued benefit (sometimes known as a "lump sum distribution"). By permitting "rollovers" of partial distributions, the bill would encourage employees to continue to save for retirement.

ERIC has long supported proposals to encourage private savings and generally supports H.R. 4473, provided that no qualified plan should be required to make a partial distribution to a terminating employee, regardless of the employee's desires.

Provisions regarding distributions upon termination of employment vary greatly among qualified plans. Some plans "cash out" terminating employees in order to avoid undue administrative costs; others do not. Some plans permit partial distributions to former employees; others do not. Whether such distributions are permitted, however, must be within the discretion of the plan. For example, many plans may wish to avoid the significant and disproportionately large costs which could be incurred in administering small accounts if a number of employees withdraw substantial portions (but not all) of their accrued benefits.

Because H.R. 4473 would allow, but not require, any qualified plan to amend its current distribution rules to permit partial withdrawals, ERIC supports it.

Respectfully,

Jerry L. Oppenheimer

JLO/sa

Retroactive Date for Restricted Property Provision in Economic Recovery Tax Act of 1981

97TH CONGRESS
1ST SESSION

H. R. 4577

To amend Public Law 97-34.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 23, 1981

Mr. COELHO introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend Public Law 97-34.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

PROPERTY TRANSFERRED TO EMPLOYEES SUBJECT TO CERTAIN RESTRICTIONS

Subsection (c) of section 252 of Public Law 97-34 (95 Stat. 260) is amended by striking the words "December 31, 1981" and inserting in lieu thereof "June 30, 1969" and by adding the following paragraph: "The amendments made by this section shall apply in the case of a taxable year beginning before January 1, 1984, only if the person to whom the property is transferred elects (in such manner as the Secretary of the Treasury or his delegate shall prescribe) to have such amendments apply.".

SUMMARY AND DESCRIPTION

Present law

In general

Under the present law rules relating to transfers of property in connection with the performance of services (Code sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forfeiture.[1] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forfeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received.[2] In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 (ERTA), the U.S. Tax Court had ruled[3] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934[4] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of receipt could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

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[1] An employer generally is allowed a business expense deduction when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).

[2] See note 1.

[3] *Horwith v. Comm'r*, 71 T.C. 932 (1979).

[4] 15 U.S.C. § 78p(b).

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following receipt of the stock during which that section applies. Thus, unless the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct) at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130)) and 135 ((1/18/73) 38 FR 1734; CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

Issue

The principal issue is whether taxpayers should be allowed to elect to have the amendments made by section 252 of ERTA apply retroactively.

Explanation of the bill

Under the bill, the amendments to section 83 made by section 252 of ERTA would apply to taxable years ending after June 30, 1969, i.e., to all taxable years to which section 83 applies. However, in the case of any taxable year beginning before January 1, 1984, the amendments made by section 252 of ERTA would not apply unless the taxpayer to whom the stock was transferred makes an election to have such amendments apply to such taxable year. The election would have to be made in the manner prescribed by the Treasury Department.

Effective date

The bill would be effective on enactment. The amendments made by the bill would apply to taxable years ending after June 30, 1969.

Revenue effect

It is estimated that the bill would reduce receipts by less than $5 million annually.

Repeal of Income Tax Withholding on Certain Gambling Winnings; Modification of Information Reporting Requirements; and Carryovers of Net Gambling Losses

97TH CONGRESS
1ST SESSION

H. R. 4592

To amend the Internal Revenue Code of 1954 to eliminate the withholding requirement with respect to gambling winnings, to provide that information returns with respect to gambling winnings shall be required only in cases of payments of $10,000 or more, and to allow a 3-year carryover of net gambling losses.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 24, 1981

Mr. HOLLAND introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to eliminate the withholding requirement with respect to gambling winnings, to provide that information returns with respect to gambling winnings shall be required only in cases of payments of $10,000 or more, and to allow a 3-year carryover of net gambling losses.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. ELIMINATION OF WITHHOLDING REQUIREMENT WITH RESPECT TO GAMBLING WINNINGS.

(a) In General.—Section 3402 of the Internal Revenue Code of 1954 (relating to income tax collected at source) is amended by striking out subsection (q).

(b) Effective Date.—The amendment made by subsection (a) shall apply to payments made after the date of the enactment of this Act.

SEC. 2. REQUIREMENT OF INFORMATION RETURNS WITH RESPECT TO GAMBLING WINNINGS ONLY IN CASES OF PAYMENTS OF $10,000 OR MORE.

(a) In General.—Section 6041 of the Internal Revenue Code of 1954 (relating to information at source) is amended by adding at the end thereof the following new subsection:

"(f) Gambling Winnings of $10,000 or More.—With respect to gambling winnings, subsection (a) shall be applied by substituting '$10,000' for '$600'."

(b) Effective Date.—The amendment made by subsection (a) shall apply to payments made in taxable years ending after the date of the enactment of this Act.

SEC. 3. 3-YEAR CARRYOVER OF NET GAMBLING LOSSES.

(a) In General.—Subsection (d) of section 165 of the Internal Revenue Code of 1954 (relating to deductions for wagering losses) is amended to read as follows:

"(d) Wagering Losses.—

"(1) GENERAL RULE.—Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

"(2) WAGERING LOSS CARRYOVER.—

"(A) IN GENERAL.—In the case of an individual, the amount of the net wagering loss for the taxable year (hereinafter in this paragraph referred to as the 'unused deduction year') shall be—

"(i) a wagering loss carryback to each of the 3 taxable years preceding the unused deduction year, and

"(ii) a wagering loss carryforward to each of the 3 taxable years following the unused deduction year,

and shall be treated as a loss from a wagering transaction for such year. The entire amount of the unused deduction for an unused deduction year shall be carried to the earliest of the 6 taxable years to which (by reason of clauses (i) and (ii)) such deduction may be carried, and then to each of the other 5 taxable years to the extent that, because of the limitation contained in subparagraph (B), such unused deduction may not be added for a prior taxable year to which such unused deduction may be carried.

"(B) LIMITATION.—The amount of the unused deduction which may be added under subparagraph (A) for a preceding or succeeding taxable year shall not exceed the amount by which the gains from wagering transactions for such taxable year exceed the sum of—

"(i) the losses from wagering transactions during the taxable year, and

"(ii) the amounts which, by reason of this paragraph, are added to the amount allowable for such taxable year and attributable to taxable years preceding the unused deduction year.

"(3) NET WAGERING LOSS DEFINED.—For purposes of this subsection, the term 'net wagering loss' means the excess of the net wagering losses for the taxable year over the net wagering gains for such year, as determined without regard to any carryover to such year."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to unused deduction years beginning after December 31, 1981.

SUMMARY AND DESCRIPTION

Present law

Withholding requirements

In certain circumstances, present law requires income tax to be withheld from gambling winnings at a rate of 20 percent (Code sec. 3402(q)). The general rule is that gambling winnings are subject to withholding if the amount of proceeds from a wager exceeds $1,000 and also is at least 300 times as large as the amount wagered.[1]

Special rules apply to certain types of wagers. First, all winnings of more than $1,000 from a wager placed in a sweepstakes, wagering pool, or lottery (other than a State-conducted lottery) are subject to withholding, regardless of the amount wagered. Second, winnings of more than $5,000 from a wager placed in a State-conducted lottery are subject to withholding, and winnings of $5,000 or less from such a lottery are not subject to withholding, regardless of the amount wagered. Third, winnings from a slot machine, keno, or bingo are exempt from withholding.

If these rules require withholding, the entire amount of winnings (not merely any excess over the $1,000 or $5,000 threshold amount) is subject to withholding. If multiple wagers are placed on a single event, the winnings on each such wager are aggregated to determine whether the $1,000 or $5,000 threshold is exceeded. For example, if one $100 and two $50 wagers are placed on a single horse in a race, amounts paid on the three tickets would be added together, and the price of all three tickets would be deducted, to determine whether the winnings were subject to withholding. On the other hand, if wagers are placed by one person on different horses or on different races, the bettor's winnings from the wagers would not be aggregated for purposes of the withholding requirements.

Required information reports

Any person who is to receive a payment of gambling winnings subject to withholding must furnish the payor with a statement containing his or her name, address, and taxpayer identification (social security) number (sec. 3402(q)(6)). A payor of gambling winnings must report payments subject to withholding to the Internal Revenue Service. Where gambling winnings are less than the threshold amounts for withholding, proposed Treasury regulations would permit a payor to rely on a written statement from the recipient in determining whether multiple wagers must be aggregated and income tax withheld (Prop. Treas. Reg. § 1.6011-3).

In the case of winnings from a slot machine, keno, and bingo (which are not subject to withholding), Treasury regulations require the payor to report to the Internal Revenue Service on winnings of $1,500 or more from keno, or $1,200 or more from bingo or slot machines (Reg. § 7.6041-1).

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[1] The statute expressly applies this general rule to such proceeds from a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai.

IRS report

The Tax Reform Act of 1976, which added the withholding requirement on the ground that "many taxpayers did not report" certain gambling winnings on their tax returns,[8] also required the Internal Revenue Service to report to the tax-writing committees on the operation of the reporting system on winnings from keno, bingo, and slot machines, and to make recommendations as to whether those winnings also should be subject to withholding.[9] In a December 1980 report ("Compliance in Reporting Gambling Winnings"), the Service recommended that, "because of the significantly greater compliance demonstrated by individuals subject to withholding as compared to those subject only to information reporting," (1) withholding should be required on winnings of $1,500 or more from keno and $1,200 or more from bingo and slot machines, and (2) the withholding threshold should be lowered to $600 for horse racing, dog racing, and jai alai wagers, if the amount of proceeds from the wager is at least 300 times as large as the amount wagered, and for sweepstakes, wagering pools, and lotteries (including State-conducted lotteries).

Income tax deduction of net gambling losses

Present law permits a limited deduction for income tax purposes of an individual's gambling losses (sec. 165). The deduction is allowable only in the taxable year in which the loss is incurred and is allowable only to the extent of gambling winnings in that year.

Issues

The issues are (1) whether present law requirements for income tax withholding on gambling winnings should be repealed; (2) whether payors of gambling winnings should be required to report to the Internal Revenue Service only winnings of $10,000 or more; and (3) whether individual taxpayers should be able to carry over excess net gambling losses to offset gambling winnings in the three preceding and three following years.

Explanation of the bill

The bill would repeal the provisions of present law requiring income tax withholding on certain gambling winnings. Also, the bill would provide, in place of the present law withholding and information reporting requirements, that a payor of any gambling winnings of $10,000 or more must report such winnings to the Internal Revenue Service pursuant to section 6041.

Also, the bill would permit a three-year carryback and a three-year carryforward of net gambling losses. The bill would not, however, change the present rule that gambling losses may be deducted in any taxable year only to the extent of gambling winnings. Under the bill, losses would first be carried back to the earliest of the three preceding taxable years in which gambling winnings exceeded such losses. Any unused loss in that year would then be applied sequentially against net gambling winnings in each of the succeeding five taxable years.

Effective date

The repeal of present law income tax withholding requirements would apply to payments of gambling winnings after the date of enactment. The modifications to present law information reporting requirements would apply to payments made in taxable years ending after enactment. The allowance of carryovers of unused gambling losses would apply to taxable years beginning after December 31, 1981.

Revenue effect

It is estimated that the bill would reduce fiscal year budget receipts by $20 million in 1982, $87 million in 1983, $52 million in 1984, $55 million in 1985, and $57 million in 1986.

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[8] House Rpt. 94-658, 94th Cong., 1st Sess. (1975), at p. 297; Sen. Rpt. 94-938, 94th Cong., 2d Sess. (1976), at p. 383.

[9] House Rpt. 94-1515, 94th Cong., 2d Sess. (1976), at p. 483.

ANALYSIS SUBMITTED BY CLIVE B. JONES, VICE PRESIDENT, ECONOMICS RESEARCH ASSOCIATES; THOMAS G. VITEZ, CONSULTANT, RETIRED INTERNAL REVENUE SERVICE OFFICIAL; THOMAS L. ARONSON, DIRECTOR OF RESEARCH, AMERICAN HORSE COUNCIL; AND EUGENE M. CHRISTIANSEN, SPECIAL ASSISTANT, NEW YORK CITY OFF-TRACK BETTING CORP.

S. 1861 / H.R. 4592

Federal Revenue Implications of Repeal Of Withholding

	In $ Millions	
Gross Estimated Tax Collections From Withholding in 1977		$100
Less Amounts Over-Withheld		
A. Withheld from persons not required to file	$ 2.4	
B. Excess withholding from persons with		
1. No tax liability		
2. Partial refund due	$29.5	
= Adjusted Tax Collection From Withholding		$68
Less Amounts Withheld From Taxpayers Who Comply Voluntarily	$59	
= DIRECT REVENUE YIELD FROM WITHHOLDING SYSTEM		$ 9.0
Less Negative Tax Adjustment (see C below)	$ 5.9	
= ADJUSTED FEDERAL REVENUE YIELD		$ 3.1

Negative Impact of Withholding

Decrease In Revenues Due To Decreased Cash Flow	
A. To State and local governments	($15.4)
B. To pari-mutuel industry	($24.9)
C. To Federal government	($ 5.9)
= Direct Negative Impact	($46.2)

NOTES

1) "Gross Estimated Tax Collections." Collections are defined as gross monies withheld and remitted to IRS, without regard to amounts returned or returnable to the taxpayer. The actual amount received in 1977 was $69 million for an eight month period, and the Internal Revenue Service estimate as to the total amount for the calendar year was $100 million. (Department of the Treasury, Internal Revenue Service Document 6643, 12/80, "Study of Compliance in Reporting Gambling Winnings - Tax Year 1977.")

2) "Withheld From Persons Not Required to File." IRS reports that 2.4% of persons who were withheld upon were not required to file. The amount unnecessarily withheld from these persons was $2.4 million.

3) "Excess Withholding From Persons With (1) No Tax Liability; (2) Partial Refund Due." IRS reports that an additional 12.1% of persons who were withheld upon had no tax liability. In addition, an analysis of New York OTB statistics shows that another 30% of the taxpayers were due a partial refund on their withheld amount. The average percentage refund for this group was 46%. The amount unnecessarily withheld from persons due full or partial refunds was $29.6 million.

4) "Withheld From Taxpayers Who Comply Voluntarily." There are no IRS figures available with respect to the tax impact of unreported winnings - i.e. unpaid taxes on reportable winnings as the percentage of total taxes due on such winnings. For purposes of this calculation, it is assumed that the tax compliance and income compliance rates are the same: 86.7%, per Table 6, IRS Document 6643.

Accordingly:

Adjusted tax collection from withholding:	$68.0 million
Applicable percentage (86.7%):	.867
Amount withheld on winnings reported voluntarily:	$59.0 million
Net revenue yield from withholding system:	$ 9.0 million

Note: IRS experience indicates that the withholding system has a positive effect on voluntary compliance. Thus, if withholding were repealed, voluntary compliance could possibly decline. Using the IRS figures contained in Table 6, supra., voluntary compliance without withholding could decline to 68.1%. Using this "worst case scenario," the net revenue yield from the withholding system could be as high as $21.7 million.

5) "Decrease in Revenues Due to Decreased Cash Flow (A) To State and Local Governments; (B) To Pari-Mutuel Industry; and (C) To Federal Government." Each dollar at a pari-mutuel facility is wagered and rewagered an average of 3.5 times (due to the return to patrons of an average 80% of wagering pools and the subsequent rebetting of those same dollars). Every dollar artificially removed from the betting stream therefore translates into $3.50 in reduced overall wagering. The $65.9 million withheld from pari-mutuel patrons in 1977 translates into $231 million in reduced wagering nationwide. Assessing a 20% takeout (a subtraction from each pari-mutuel pool which accounts for revenues to governments and the industry) on that $231 million yields a $46.2 million revenue shortfall

to the partners in the pari-mutuel system in 1977 alone.

Of the $46.2 million, roughly one-third represents revenues that would go to State and local governments. The $30.8 million remainder represents revenues that would go to the pari-mutuel industry and its participants (corporate facilities, horsemen, etc.).

The $30.8 million revenue shortfall includes a decrease in Federal government revenues from corporate and individual taxes. An extremely conservative assumption that 50% of the revenue figure represents incremental profits (and 50% represents costs to generate those profits) was applied. This leaves a $15.4 million profit figure, which when affected by an average 38% tax rate would represent a $5.9 million Federal tax revenue shortfall.

6) "Direct Negative Impact." This computation does not take into account the costs borne by the Internal Revenue Service and the industry for administration and monitoring of the tax (at least 313,000 forms).

It also does not factor in the lost revenues associated with the change in wagering patterns withholding has caused. An independent survey of Off-Track Betting patrons has indicated that nearly 40% of W2-G recipients say they reduced their betting due to reporting and withholding requirements. The net reduction in betting amounted to 14%.

Finally, it does not attempt to estimate the portion of sums now wagered illegally that would flow into legal channels due to improvement of the tax situation that withholding repeal would represent. Seventy percent (70%) of respondents to the independent OTB survey agreed that withholding and reporting encourage persons to bet with illegal bookmakers.

It has been estimated by IRS that from $12.2 billion to $15.4 billion is wagered annually in illegal games for which various states have sought to provide legal alternatives. Even a small portion of this amount attracted by repeal of withholding would represent a huge infusion of wagering dollars into the legal system and would subsequently increase tax revenues to Federal, State and local governments and the industry.

STATEMENT OF THE AMERICAN GREYHOUND TRACK OPERATORS ASSOCIATION

The American Greyhound Track Operators Association is a non-profit corporation composed of the owners and operators of the greyhound tracks throughout the United States. Our Association is truly national in that it represents 45 greyhound tracks located in the 14 states where legalized greyhound racing is conducted.

Mr. Chairman, we appreciate the opportunity this Committee has allowed us in presenting our views in support of the bill H.R. 4592, and before going to the three major provisions of this legislation let us first review the current law on the subject.

As you know, current law provides that with respect to pari-mutuel wagering, which includes greyhound racing, the track must deduct and withhold a tax in an amount equal to 20 percent of any payment of winnings where such amount exceeds $1,000 and where the betting odds are at least 300 to 1 (Int. Rev. Code of 1954, § 3402q).

Further, dog tracks and other legalized wagering establishments must file information returns (Forms W-2G) when the winnings of each bettor is $600 or more (Int. Rev. Code of 1954, § 6041a) and where the payout is based on betting odds of at least 300 to 1.

Current law also provides that losses from wagering transactions are deductible only to the extent of gains from such wagering transactions in the same taxable year (Int. Rev. Code of 1954, § 165d). Net wagering losses are not permitted to be carried over to a later or earlier taxable year.

Mr. Chairman, the bill, H.R. 4592, introduced by the distinguished gentleman from South Carolina, Mr. Holland, provides for the repeal of the provision requiring withholding on certain gambling winnings (Code sec. 3402q). Also, the bill would amend current law regarding the filing of information returns (Code sec. 6041a) by requiring the payor of gambling winnings to file an information return on gambling winnings only in cases of payments of $10,000 or more.

H.R. 4592 would also permit a three year carryback/carryforward of net wagering losses. The bill defines a "net wagering loss" as "the excess of the net wagering losses for the taxable year over the net wagering gains for such year, as determined without regard to any carryover to such year."

Mr. Chairman, the imposition of withholding on the greyhound pari-mutuel industry and its patrons was an outgrowth of Treasury Department and Internal Revenue Service determinations that such on-site tax collections would ensure compliance with Federal tax laws and generate significant, uncollected tax revenues for the Federal Government. This has proven false.

The facts have proven that withholding is unproductive for the Federal Government. Withholding simply does not generate the incremental revenue originally projected by the Treasury Department. More importantly, any Federal revenues actually realized necessarily come at the expense of the States and the pari-mutuel greyhound industry. Furthermore, it should be pointed out that in 1977 the Internal Revenue Service conducted a study of compliance in withholding on certain gambling winnings. Interestingly enough, this IRS study revealed that *at worse* the difference between a withholding system and no withholding was a mere 13 percent. Further, the study indicated that compliance was affected more by other factors, for example, the size of the winnings -- where it has been found that the larger the win, the higher the compliance. Contrary to Treasury's position, withholding *per se* has very little correlation to overall compliance.

Withholding from legal payoffs at the race tracks is really not a revenue issue. Even the Honorable John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy, stated before this Committee that this area of withholding was not a significantly fertile field in the production of tax related revenues. On the other hand, this is an issue that vitally affects the 14 State governments which have legalized pari-mutuel wagering on greyhound racing. These States have legalized greyhound racing for a variety of different reasons. However, raising revenues, enhancing economic development and reducing illegal gambling are paramount among the reasons given.

The Federal Commission on the Review of the National Policy Toward Gambling in their final report to the Congress in 1976, condemned withholding as an unwarranted Federal infringement on State policy decisions designed to raise revenues, stimulate economic development and aid local law enforcement efforts through legal gambling legislation. Four years of experience with the required withholding from the legal payouts at the race tracks has confirmed this warning.

Withholding has ranged far from its original legislative intent in terms of both impact and effect. It causes the collection of taxes on transactions that ultimately generate no tax liability and has seriously damaged the greyhound pari-mutuel industry. Withholding has reduced State tax revenues where grey hound racing is permitted, thereby adversely affecting needed programs which those State taxes support.

The negative effects of withholding are passed directly from the patron to the greyhound pari-mutuel industry. The greyhound race track relies on the patrons' participation for its financial health since the race track receives a percentage of the wagering for providing the facilities. It is important to understand that for each dollar wagered at a race track, it is rewagered on an average of 3½ times. Therefore, one dollar artificially removed from the betting system translates into $3.50 in reduced overall wagering upon which the States' taxes and race tracks' income is derived. The reduced handle caused by withholding also impacts directly on the purses paid to competing kennels, in that, these purses are calculated on the amount of the handle wagered. This "trickle-down" negative economic effect also affects other segments of the local economy where the race track is located. Fewer goods and services are purchased, fewer persons are hired and less money goes into the local economic system -- thereby reducing local tax revenues while at the same time increasing the burden on those services provided by State and local government.

Finally, the withholding has uniquely determinable effects on pari-mutuel greyhound operations which were not recognized or considered when the tax was imposed. Withholding attempts to enforce by extraordinary means, tax compliance in an area where no such unusual measures are necessary and, by corollary, actually confiscates tax dollar monies that rightfully should be returned to the pari-mutuel greyhound patron. In most instances, those patrons are unable to retrieve dollars lost due to the complex and discriminatory tax regulations that govern legal wagering activity. This is because the IRS standards for substantiation of off-setting losses against winnings are nearly impossible for the average patron to meet. Most patrons record net losses from their wagering transactions over the long term and in the rare instance, that a patron can comply with the off-setting loss standards, he/she must give up the standard zero-bracket deduction to claim those losses. Financially, this is an unreasonable burden for the vast majority of American taxpayers who use the standard or zero-bracket method of reporting.

Mr. Chairman, the American Greyhound Track Operators Association urges the enactment of H.R. 4592 and we wish to thank this Committee for allowing us the opportunity of presenting our views. Further, we are advised that James E. Ritchie, Attorney at Law, on March 12, 1982, submitted a position paper on behalf of the legal gaming and wagering industry. As a part of that industry we wish to note our full acquiescence in and support of this industry-wide position paper which we are advised will appear in today's hearing record.

Thank you.

STATEMENT OF SAUL F. LEONARD, C.P.A., NATIONAL PARTNER—LEISURE TIME INDUSTRIES AND NATIONAL PARTNER—GAMING INDUSTRY; LAVENTHOL & HORWATH

I am Saul F. Leonard, National Partner - Leisure Time Industries and National Partner - Gaming Industry for the international accounting firm of Laventhol & Horwath. I appear here today on behalf of my firm and to speak about the accounting profession's role in instituting auditing and internal control procedures for the casino gaming industry.

Laventhol & Horwath is internationally recognized as a leader in this highly specialized discipline. We produce and publish a number of definitive studies on the casino gaming industry and I contribute regular articles to 'Gaming Business' magazine. Our firm also sponsors an annual symposium devoted to the gaming industry. This meeting serves as an international forum for the discussion and exchange of ideas between leaders of industry, government, legal and investment-banking communities, and others concerned with the gaming industry.

We are the auditors for the hotel/casino corporation, both domestically and internationally. This activity is an outgrowth of our firm's expertise in the lodging industry, in which we have specialized for more than 65 years. We have also devised and instituted internal control systems and procedures for casinos which have established the framework for industry standards.

Much of our professional consulting work involves close cooperation with government regulatory agencies. In my view, continued cooperation between the accounting profession and government authorities is strongly in the public interest and will lead to further refinements and improvements in casino controls. Concommitant with this, I now represent our firm on a committee of the American Institute of Certified Public Accountants which is preparing a casino audit guide that will serve as the standard reference guide for the accounting profession in this field.

In addition to the areas just mentioned, my partners and I have testified on a number of occasions before federal and state agencies examining the subject of legalized gaming, including the Federal Commission on the Review of the National Policy Toward Gambling. We have testified before New Jersey governmental committees, Nevada authorities, and the New York State Legislative committee which examined the potentials of legalized casino gaming. Our counsel has been sought by other governmental agencies, both in the U.S. and abroad, who are examining the possibilities of legal-

Other witnesses here today have given their expert testimony on the volume and growth of the various forms of legalized gaming activities in the United States, and the economic contributions of these activities to the national economy. As an accountant, I would like to devote my remarks to the subject of the auditability and accountability of casinos and the integrity of their operational procedures.

Invariably, whenever the subject of casino gaming is brought up, the question is raised: "With all that cash being passed back and forth in a casino, can genuine controls be established?"

In other words, can federal, state and local governments --which in the final analysis is the American public -- be asured that an honest accounting is being made, and that these businesses pay their correct share of taxes?

My answer to that is an unqualified yes.

I make this assertion after more than fifteen years of experience in casino accounting matters, and after having examined or reviewed the internal control procedures of more than a dozen major casinos.

Unfortunately "old wives tales" die hard. There still exist a number of individuals who have mistaken impressions about the casino gaming industry. One of the most prevalent misimpressions is that because a gaming casino's principal stock in trade is cash, or its equivalent, controls are virtually impossible to establish or maintain.

This simply is not so. There are many other businesses, such as banks or savings and loan associations, where cash is the principal stock in trade. These enterprises have always been considered accountable and auditable. The keystone -- as in any business -- is a proper system of controls. The same holds true for casinos.

In other words, the ability to control and audit the cash flow of a business does not depend on the nature of the business, but rather the manner in which it is conducted. In the gaming business -- whether it consists of laying out cash for a wager on a horse or on a turn of the cards or dice -- what matters most is that institution's system of internal controls.

As part of Laventhol & Horwath's contributions toward establishing a high degree of integrity for accounting procedures in the casino industry, we have devised and assisted management to establish and maintain elaborate internal control systems, starting with the cash and chips in the casino cage.

I don't wish to bore you with the complex details of these control systems. Suffice to say that these explicit procedures are part and parcel of doing business in both Nevada and New Jersey. The casinos must follow regulations prescribed by state government authorities and the operating procedures must be approved by the casino's independent auditors.

In addition to these internal control procedures, more and more sophisticated electronic surveillance systems are being utilized each year. These depend largely on the use of closed circuit television cameras. A typical major casino in Nevada or Atlantic City may use as many as 200 cameras on 24 hour duty. These "eyes in the sky" cover every game being played in the house and reach into all corners of the casino, including the cashier's cage and money-counting area. Cameras are so sophisticated that they can read the digits on a dollar bill. Such a system also includes videotape recording systems, which routinely transcribe many of the casino's activities.

The utilization of surveillance systems is only one of the many procedures developed by this industry to ensure proper controls. There are meters on slot machines that record the total amount wagered, payoffs to amount wagered, payoffs to customers and similar type of information so that the amount wagered and the amount paid out can be compared with actual cash totals. The industry also has developed computer applications to provide management with current information and control on it operations and have the proper tools to record the financial information.

In sum, I would like to emphasize that procedures have been developed and are in place for every aspect of casino operations. The accounting profession continues to work closely with government authorities on one hand and clients on the other to ensure that the highest accounting standards are met and maintained.

These procedures help ensure that the operating results reported by a casino to governmental authorities accurately reflect the results of their business and also provide for adequate protection for the public regarding the integrity of the casino's operations.

Taking the industry as a whole, I think it is important to note that fundamental and far-reaching changes have taken place in it over recent years.

Today, most of the major hotel/casinos in both Nevada and Atlantic City are owned and operated by large publicly-held corporations. Many are listed on the New York or the American Stock Exchange. Over and above their interest in casino operations, these corporations -- their boards and their officers -- have a deep commitment to the highest business standards. It is they who have been in the vanguard of setting criteria which all others in the industry must follow.

In short, in my opinion the legalized hotel/casino industry operating with proper controls, is here to stay, and will likely expand into other states over the next few years. In an opinion poll conducted by Laventhol & Horwath last fall, seventy-one percent of industry leaders who responded concurred. Two years ago I personally made the prediction that by 1990, no resort area in the country could be operating profitably without some form of legalized casino gaming. I stick by this statement.

As brought out by others here today, the casino gaming industry is the prime economic force in Nevada; in Atlantic City it has contributed over one billion dollars in construction projects which are contributing to the revitalization of that seaside resort.

As to the taxing of gaming winnings, may I remind you that in 1976 the Federal Commission on the Review of the National Policy Toward Gaming argued against such a philosophy. The report stated that such a policy would serve as an impairment to legal wagering, and, in the final analysis be counterproductive. The negative effect of such a tax on revenues produced by legalized gaming and the allied areas serving the industry would far exceed any positive results of instituting such a tax.

What you ultimately decide in this committee will influence, to a great extent, how efficiently and successfully legalized gaming operations in your own constituencies will be able to operate in the future.

Thank you for the opportunity of appearing here today. I will be pleased to answer any questions.

STATEMENT OF HON. PAUL LAXALT, A U.S. SENATOR FROM THE STATE OF NEVADA

Mr. Chairman, members of the Subcommittee:

I am pleased to add my strong support for H.R. 4592, a measure to correct three serious inequities in the tax code that have a devastating effect on the legal gaming industry.

Specifically, H.R. 4592, which is substantially identical to a bill Senator Cannon and I introduced in the Senate, S. 1861, would eliminate withholding from parimutuel and state lottery payouts, simplify reporting of gaming winnings and allow a three-year carryover of net wagering losses. Enactment of this bill would not only provide for fair treatment of the taxpayer, it would also strengthen the legal gaming industry and would protect state revenues.

The legal gaming industry in Nevada is privately owned and operated, but strictly monitored by the state and federal regulatory and law enforcement agencies. It is the largest source of revenue in Nevada, just as over 30 states rely on gaming as a source of revenue. As the federal budget is reduced and the states are asked to assume greater responsibilities, it is increasingly important to eliminate federal taxes that impede state revenue sources.

Federal withholding on gaming payouts is clearly one such impediment. Actual federal revenues collected due to withholding are relatively small. More importantly, this figure is dwarfed by the losses to state and local government and gaming industry revenue attributable to withholding. Earlier this session, representatives of state-operated and franchised gaming establishments, which generate more than $1 billion a year, testified to the destructive effect of withholding on legal gaming industries and the resulting loss of revenue. Gaming winnings are normally bet again, and eventually lost. Consequently, withholding from payouts, which usually do not produce a year-end tax liability, merely extracts dollars from the cash flow upon which the gaming industries and state gaming taxes depend without augmenting federal revenues by any commensurate amount.

For that reason, when he was campaigning for office, President Reagan condemned the withholding from parimutuel payouts instituted by the previous Administration and firmly opposed federal interference in state-operating and state-regulated gaming industries. In addition, in 1976, the Federal Commission on the Review of the National Policy Toward Gambling opposed withholding from legal payouts on the grounds that it would generate minimal government revenues and create an advantage for the illegal operators.

Another provision of H.R. 4592 would alter the reporting requirements of legal gaming payouts. Currently, the IRS requires casinos to report each payout of $1200 or more at bingo and slot machines and $1500 at keno games through an information return, Form W2-6, with a copy to the taxpayer.

This requirement collects only a small amount of federal tax revenues--about $10 million in 1980. Yet it imposes heavy cost and regulatory burdens on the casinos. It also inhibits the player. The vast majority of players lose more than they win over the long run. They cannot deduct their gaming losses from ordinary income, only from gaming winnings if they can adequately document the losses and if they itemize their deductions. As a practical matter, most players do not even attempt to deduct their losses. To require reporting and eventual taxation of small wins that are more than offset by losses greatly inhibits legal play. Raising the reporting limits to $10,000 would reduce the adverse burdens on the casinos and the players, while continuing to catch the windfall winners.

The third provision of H.R. 4592 would allow taxpayers, who can document their losses, to carry these losses forward up to three years. As I mentioned before, gaming losses can only be deducted from winnings. Thus, this provision does not affect other income. It only provides for realistic long-term treatment of gaming wins and losses by the taxpayer.

In short, H.R. 4592 will enact three much needed reforms in the tax laws affecting the gaming industry. When the reforms are enacted they will increase legal play at the expense of the illegal. This, in turn, will increase the revenue of the industry and state, local, and federal tax revenues.

For all these reasons, I urge you to support H.R. 4592.

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- Atlantic Region
- Ontario
- Quebec
- Western Region

March 19, 1982

Honorable Fortney H. Stark
Chairman
Sub-Committee on Select Revenue Measures
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Stark and Members of the Sub-Committee:

The National Association of State Lotteries respectfully requests to file this written statement for the printed record in support of H.R. 4592.

The membership of the N.A.S.L. is comprised of the Provinces of Canada, the Virgin Islands, Puerto Rico and the fifteen (15) lottery states of the United States. The lottery states are Arizona, Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island and Vermont.

These lotteries were created by the various state legislatures and are operated by agencies of the state governments. The revenues from the state operated lotteries go either to the general fund of the state government or to a special fund of the state government for a specified benefit program.

Today, as more responsibility and authority for government programs is being placed upon the state governments, the revenue generation programs of the state governments should be given full encouragement and support by the federal government.

While the National Association of State Lotteries strongly supports the provisions of H.R. 4592, which would include the elimination of the withholding requirements with respect to lottery winnings, we encourage your Committee to go even further and consider the exemption of state lottery winnings from the Federal Personal Income Tax. This action would have a negligible impact on the federal government, but would have a dramatic positive impact on the state operated lotteries and the governmental programs supported by the profits of those lotteries.

We should point out that the Canadian Federal Government has exempted the provincial lottery winnings from the Canadian Federal Personal Income Tax, with very favorable results in increased revenues to the Provincial Governments and benefits to the Canadian citizens.

Your positive consideration of our request will have similar favorable results in benefits to our states and our citizens.

Sincerely,

Lynn R. Nelson
President

Tax-Exempt Status of Athletic Organizations Providing Facilities or Equipment

97TH CONGRESS
1ST SESSION

H. R. 4990

To amend the Internal Revenue Code of 1954 to clarify the status of certain amateur athletic organizations.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 16, 1981

Mr. VANDER JAGT (for himself and Mr. GUARINI) introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 to clarify the status of certain amateur athletic organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. AMENDMENTS TO SECTION 501.

(a) Section 501(c)(3) of the Internal Revenue Code of 1954 (describing certain organizations exempt from tax) is amended by striking "(but only if no part of its activities involve the provision of athletic facilities or equipment)".

SEC. 2. AMENDMENTS TO SECTION 170.

(a) Section 170 of such Code (relating to allowance of a deduction for certain charitable, etc., contributions and gifts) is amended—

(1) by striking from subsection (c)(2)(B) thereof "(but only if no part of its activities involve the provision of athletic facilities or equipment)"; and

(2) by adding at the end of subsection (f) thereof the following new paragraph (7):

"(7) DENIAL OF DEDUCTION FOR CERTAIN CONTRIBUTIONS TO AMATEUR ATHLETIC ORGANIZATIONS.—

"(A) IN GENERAL.—No deduction shall be allowed under this section for any contribution to or for the use of an organization organized and operated exclusively to foster national or international amateur sports competition (as described in subsection (c)(2)(B)) if—

"(i) the contribution is made by a person, or by a member of the family (as defined in section 267(c)(4)) of a person, who uses any athletic facility or equipment provided by, such organization;

"(ii) the use occurs within a period beginning 12 months before and ending 12 months after the date the contribution is made.

"(B) EXCEPTIONS.—

"(i) Subparagraph (A) shall apply only to contributions in excess of $500 in the aggregate made within the taxable year by the person and members of the family of the person described in such subparagraph.

"(ii) Subparagraph (A) shall not apply to a contribution to the United States Olympic Committee or a national governing body as defined in the Amateur Sports Act of 1978 (36 U.S.C. 371).

"(iii) Subparagraph (A) shall not apply to a contribution of unreimbursed expenditures made incident to the rendition of services by a noncompetitor to an organization contributions to which are deductible."

SEC. 3. AMENDMENTS TO SECTION 2055.

(a) Section 2055 of such Code (relating to the allowance of estate tax deduction for transfers for public, charitable, and religious users) is amended—

(1) by striking from subsection (a)(2) thereof "(but only if no part of its activities involve the provision of athletic facilities or equipment)"; and

(2) by adding at the end of subsection (e) thereof the following new paragraph (4):

"(4) DENIAL OF DEDUCTION FOR CERTAIN CONTRIBUTIONS TO AMATEUR ATHLETIC ORGANIZATIONS.—

"(A) IN GENERAL.—No deduction shall be allowed under this section for any contribution to or for the use of an organization organized and operated exclusively to foster national or international amateur sports competition (as described in subsection (a)(2)) if—

"(i) the contribution is made by the estate of a person, or of a member of the family (as defined in section 267(c)(4)) of a person, who used any athletic facility or equipment provided by, such organization; and

"(ii) the use occurred within a period beginning 12 months before and ending 12 months after the date the contribution is made.

"(B) EXCEPTIONS.—

"(i) Subparagraph (A) shall apply only to contributions in excess of $500 in the aggregate made by the estate of the person and the estates of the members of the family of the person described in such subparagraph.

"(ii) Subparagraph (A) shall not apply to a contribution to the United States Olympic Committee or a national governing body as defined in the Amateur Sports Act of 1978 (36 U.S.C. 371).

"(iii) Subparagraph (A) shall not apply to a contribution of unreimbursed expenditures made incident to the rendition of services by a noncompetitor to an organization contributions to which are deductible."

SEC. 4. AMENDMENT TO SECTION 2522.

(a) Section 2522 of such Code (relating to charitable, and similar gifts is amended—

(1) by striking from subsection (a)(2) thereof "(but only if no part of its activities involve the provision of athletic facilities or equipment)"; and

(2) by adding at the end of subsection (c) the following new paragraph (3):

"(3) DENIAL OF DEDUCTION FOR CERTAIN CONTRIBUTIONS TO AMATEUR ATHLETIC ORGANIZATIONS.—

"(A) IN GENERAL.—No deduction shall be allowed under this section for any contribution to or for the use of an organization organized and operated exclusively to foster national or international amateur sports competition (as described in subsection (a)(2)) if—

"(i) the contribution is made by a person, or by a member of the family (as defined in section 267(c)(4)) of a person, who uses any athletic facility or equipment provided by, such organization; and

"(ii) the use occurs within a period beginning 12 months before and ending 12 months after the date the contribution is made.

"(B) EXCEPTIONS.—

"(i) Subparagraph (A) shall apply only to contributions in excess of $500 in the aggregate made within the calendar year by the person and members of the family of the person described in such subparagraph.

"(ii) Subparagraph (A) shall not apply to a contribution to the United States Olympic Committee or a national governing body as defined in the Amateur Sports Act of 1978 (36 U.S.C. 371).

"(iii) Subparagraph (A) shall not apply to a contribution of unreimbursed expenditures made incident to the rendition of services by a noncompetitor to an organization contributions to which are deductible."

SEC. 5. EFFECTIVE DATES.

(a) The amendments made by sections 1(a), 2(a)(1), 3(a)(1), and 4(a)(1) shall be effective October 5, 1976.

(b) Except as provided in (a), the amendments made by this bill shall apply to contributions made after December 31, 1981, and taxable years ending after that date.

SUMMARY AND DESCRIPTION

Present law

Under amendments to Code sections 501(c)(3) and 170 made by the Tax Reform Act of 1976, an organization formed and operated to foster national or international amateur sports competition qualifies for exemption from income tax and to receive tax-deductible contributions, but only if no part of its activities involves the provision of athletic facilities or equipment. The purpose of this restriction was "to prevent the allowance" of tax benefits for "organizations which, like social clubs, provide facilities and equipment for their members."[1]

Apart from the 1976 provision, athletic organizations that teach youth or that are affiliated with charitable organizations may qualify for exemption and for eligibility to receive tax-deductible contributions under the general Code provisions concerning educational or charitable organizations.[2]

Issues

The issues are (1) whether an organization that fosters national or international amateur sports competition and which provides athletic facilities and equipment should qualify for exemption from income tax and to receive tax-deductible contributions; and (2) if so, whether contributions to the organization by a person who uses such facilities or equipment should be deductible for tax purposes.

Explanation of the bill

Under the bill, an organization formed and operated exclusively to foster national or international amateur sports competition would qualify for income tax exemption under section 501(c)(3) and to receive tax-deductible contributions, whether or not the organization provides athletic facilities or equipment.

Under the bill, deductions would not be allowed for contributions or bequests to such an athletic organization made by an individual, or by a member of the individual's family, if the individual uses any athletic facility or equipment provided by the organization, and if such use occurs within 12 months before or 12 months after the date of the contribution. However, deductions for amounts otherwise qualifying as charitable contributions would not be disallowed under the new provision, notwithstanding such use of the organization's facilities or equipment within the 12-month periods, (1) if the total contributions made to the organization by the donor and members of the donor's family for the year do not exceed $500; (2) if the contribution is to the United States Olympic Committee or a national governing body as defined in the Amateur Sports Act of 1978 (36 U.S.C. 371); or (3) if the contribution consists of unreimbursed expenditures made incident to the rendition of services by a noncompetitor to an organization qualified for tax-deductible contributions.

Effective date

The provisions of the bill regarding tax exemption and eligibility for tax-deductible contributions would be retroactively effective as of October 5, 1976 (the effective date for the 1976 amendment to sec. 501(c)(3) relating to athletic organizations). The provisions regarding the disallowance of deductions for certain contributions would apply to contributions made after 1981.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

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[1] House Rpt. No. 94–1515, 94th Cong., 2d Sess. (1976), at p. 542.

[2] See, e.g., Rev. Rul. 65–2, 1965–1 C.B. 227, and Rev. Rul. 64–275, 1964–2 C.B. 142.

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April 22, 1982

Mr. John J. Salmon
Chief Counsel
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Re: H.R. 4990

Dear Mr. Salmon:

These comments concerning H.R. 4990 ("To Amend the Internal Revenue Code of 1954 to Clarify the Status of Certain Amateur Athletic Organizations") are submitted by the National Club Association (NCA). NCA is the national trade association representing the common business interests of private golf, city, athletic, and yacht clubs. We believe that other major groups concerned with the development of such sports as golf, yachting, and tennis concur with these comments. Enactment of H.R. 4990 could have an especially beneficial impact on the game of golf, particularly if the proposal we suggest below is adopted.

We fully support the purpose of H.R. 4990. By enabling amateur athletic organizations which are tax exempt under Section 501(c)(3) of the Internal Revenue Code to provide athletic facilities or equipment, and by allowing tax deductible contributions by individuals to such organizations whether or not the organizations provide such facilities or equipment, we believe this bill will significantly encourage the development of all amateur sports.

The approach followed in H.R. 4990 is far preferable to that incorporated in S. 1757 which is now before the Senate. This Senate bill would similarly amend the tax code but only for the benefit of amateur athletic organizations concerned with sports on the program of the Olympic Games or the Pan American Games. We submit that it is not in the public interest to delegate such a critical determination affecting the tax exempt status of amateur athletic organizations to decisions of an international sports body, even one as respected as the Olympic Committee.

We recommend, however, that H.R. 4990 be amended by enhancing the deductibility features of the bill. This would achieve even more effectively the goal of promoting the development of amateur athletics. This enhancement would encourage thousands of private social clubs which are tax exempt under Section 501(c)(7) of the Code to make contributions from their investment income to Section 501(c)(3) amateur athletic organizations. At present, and under H.R. 4990, tax exempt private clubs would have to pay an unrelated business income tax on such investment income regardless of whether such contributions are made. The amendment here proposed would enable such contributions to qualify as "charitable set asides" and thus no unrelated business income tax would be required on that part of investment income.

Background

In 1969, Congress proposed to make social clubs, fraternal beneficiary societies, and voluntary employee beneficiary associations, subject to a different form of unrelated business income tax as that tax was then being extended for all exempt organizations. When H.R. 13270, which was later enacted as the Tax Reform Act of 1969, passed the House of Representatives, all three of these organizations were subject to the unrelated business income tax under what is now Sec. 512 (a)(3). Sec. 512(a)(3) was meant to tax, among other things, the investment income of these three types of organizations unless the investment income was used for a charitable purpose, or used for the insurance function of Sec. 501(c)(8) and Sec. 501(c)(9) organizations. The allowance for the charitable "set aside" permitted to the two types of insurance organizations described in Sec. 501(c)(8) and (9) and to social clubs, was drafted by referencing it to the charitable deduction allowance for gifts to fraternal societies, viz, Sec. 170(c)(4) of the Code. It seems logical that Sec. 170(c)(4) was chosen (rather than Sec. 170(c)(2)) since an individual's gift to a fraternal benefit society is allowable as a charitable contribution deduction when the money is set aside for, among other things, charitable, educational, literary, etc., purposes.

There was no equivalent to Sec. 170(c)(4) with respect either to a social club being a donee, or to a voluntary employee beneficiary asssociation being a donee, either in 1969 or today.

The Senate Finance Committee in 1969 excused fraternal benefit societies from the application of Sec. 512(a)(3) and the Conference Committee agreed to write them out of the norms provided for by Sec. 512(a)(3). Thus, since 1970, a social club's investment income will not be subject to the unrelated business income tax if such income is "...set aside for a purpose specified in section 170(c)(4)..."

The purposes specified in Sec. 170(c)(4) are "...religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals."

Proposal

Regrettably, when Sec. 501(c)(3), and companion deduction provisions, were amended in 1976 to provide enhancements in the Internal Revenue Code for amateur athletic organizations, Sec. 170(c)(4) was not also enhanced. It is thus our recommendation that this enhancement be accomplished through H.R. 4990. This can be simply done by including in Sec. 170(c)(4) the identical provision that H.R. 4990 proposes to insert in Sec. 170(c)(2). This would make Sec. 170(c)(2) and Sec. 170(c)(4) exactly comparable with regard to deductions for furthering amateur athletics. With this comparability amendment, a contribution or a gift to or for the use of, under Sec. 170(c)(4), will be as follows:

> (4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

We believe this insertion, which is technical in nature, will permit clubs to utilize their investment income to enhance amateur athletic competition which, in large measure, they may not do now because the term "charitable" has been construed by the Service not to include enhancement of amateur athletic organizations. Social clubs obviously would have a great interest in using set aside funds for athletic activities which enhance those sports which coincide with the interests of the club's members.

Thus, if a golf club uses some of its investment income to make a contribution to an exempt amateur golf organization, it would be promoting the development of the game that is the principal focus of club activities.

We request your favorable consideration of this proposal. We would be happy to provide additional information.

Sincerely,

Gerard F. Hurley
Gerard F. Hurley, CAE
Executive Director

GFH/skw

STATEMENT OF FRANK DROZAK, PRESIDENT, MARITIME TRADES DEPARTMENT, AFL-CIO

The Maritime Trades Department (MTD) of the AFL-CIO appreciates the opportunity to express its views on H.R. 4990, a bill which would clarify the tax-exempt status of amateur athletic organizations. The MTD represents over eight million workers in 43 national and international unions.

We support the concept of H.R. 4990, a bill which clarifies the tax exempt status of amateur athletic organizations. Amateur athletics are the embodiment of sport in its purest form and deserves the support of the U. S. citizenry.

The MTD feels that the support of amateur athletic organizations is essential to the promotion of physical fitness in the United States. It has been a longstanding national policy to encourage all Americans to get in shape and stay in shape. A prime example of this is the President's Council on Physical Fitness. While the MTD is in favor of granting tax exempt status to amateur athletic organizations, we feel that the use of American-made equipment is essential. Thus, we would encourage the committee to amend H.R. 4990 to include as a precondition to becoming a tax-exempt organization, a provision requiring the use of American-made equipment. This would further our pride in both our country and ourselves..

The Olympic Games are the pinnacle of amateur athletics. National teams composed of a country's finest athletes compete to bring home the gold. The United States is no exception and every four years, America's best athletes compete against their foreign counterparts, bringing pride to every American.

Unfortunately, many Americans will not share this pride for our Olympic athletes. It has been brought to our attention that the 1984 U.S. Olympic team will be wearing uniforms manufactured in Japan, shoes made in Spain and using basketballs from Taiwan. The MTD feels that use of foreign-made equipment by American Olympic athletes is a national disgrace and a slap in the face to American workers.

The Olympic games are a showcase for American culture. From the events the United States has introduced such as basketball, to the western wear sported by our team in 1980, a little bit of America is shared with the world. We therefore find it intolerable that U. S. Olympic athletes will be using foreign-made clothing and equipment in 1984. We would hope that the Congress and the American people will act quickly to rectify this national embarrassment.

Thank you.

Deferred Compensation Plans for State Judges

97TH CONGRESS
2D SESSION

H. R. 5630

To make section 457(e)(1) of the Internal Revenue Code of 1954 inapplicable to certain State judicial plans.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 25, 1982

Mr. PICKLE introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To make section 457(e)(1) of the Internal Revenue Code of 1954 inapplicable to certain State judicial plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEFERRED COMPENSATION PLANS FOR STATE JUDGES.

(a) IN GENERAL.—Paragraph (2) of section 457(e) of the Internal Revenue Code of 1954 (relating to tax treatment of participants where plan or arrangement of State is not eligible) is amended by striking out "and" at the end of subparagraph (D), by striking out the period at the end of subparagraph (E) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(F) a qualified State judicial plan.".

(b) QUALIFIED STATE JUDICIAL PLAN DEFINED.—Paragraph (3) of section 457(e) of such Code is amended by adding at the end thereof the following new subparagraph:

"(C) QUALIFIED STATE JUDICIAL PLAN.—The term 'qualified State judicial plan' means any retirement plan of a State for the exclusive benefit of judges or their beneficiaries if—

"(i) such plan has been continuously in existence since December 31, 1978,

"(ii) under such plan, all judges eligible to benefit under the plan—

"(I) are required to participate, and

"(II) are required to contribute the same fixed percentage of their basic or regular rate of compensation as judge,

"(iii) under such plan, no judge has an option as to contributions or benefits the exercise of which would affect the amount of includible compensation,

"(iv) the retirement payments of a judge under the plan are a percentage of the compensation of judges of that State holding similar positions, and

"(v) the plan during any year does not pay benefits with respect to any participant which exceed the limitations of section 415(b).

Paragraph (1) of subsection (d) shall not apply for purposes of this subparagraph."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1978.

SUMMARY AND DESCRIPTION

Present law

Eligible State deferred compensation plan

Under present law (Code sec. 457(a)), employees of a State or local government are permitted to defer compensation under an eligible State deferred compensation plan if the deferral does not exceed prescribed annual limits (generally, the lesser of $7,500 or 33⅓ percent of includible compensation). Eligible plans are unfunded. Amounts of compensation deferred by a participant in any eligible plan, plus any income attributable to the investment of such deferred amounts, are includible in the income of the participant or the participant's beneficiary only when paid or otherwise made available under the plan.

Treatment of participants in an ineligible plan

If an unfunded deferred compensation plan fails to meet the requirements of an eligible plan, then all compensation deferred under the plan is includible currently in income by the participants unless the amounts deferred are subject to a substantial risk of forfeiture (sec. 457(e)). If amounts so deferred are subject to a substantial risk of forfeiture, then they are includible in the gross income of participants or beneficiaries in the first taxable year in which there is no substantial risk of forfeiture.

This rule for the tax treatment of participants in an ineligible plan does not apply, however, if the plan is a qualified plan, a tax-sheltered annuity program, or other funded arrangement.

Issue

The issue is whether participants in certain State judicial retirement plans should be excluded from the rule requiring participants in ineligible plans to include plan benefits in gross income merely because there is no substantial risk that the benefits will be forfeited.

Explanation of the bill

Under the bill, participants in an unfunded qualified State judicial plan would not be subject to the rule requiring participants in an ineligible plan to include plan benefits in gross income merely because there is no substantial risk that the benefits will be forfeited.

A State's unfunded retirement plan for the exclusive benefit of judges or their beneficiaries would be a qualified State judicial plan under the bill if (1) the plan has been continuously in existence since December 31, 1978; (2) all judges eligible to benefit under the plan are required to participate and to contribute the same fixed percentage of their basic or regular rate of compensation; and (3) a judge's retirement benefit under the plan is a percentage of the compensation of judges of the State holding similar positions.

In addition, the plan could not pay benefits with respect to a participant which exceed the limitations on benefits permitted under tax-qualified plans, and could not provide an option to plan participants as to contributions or benefits the exercise of which would affect the amount of the participant's currently includible compensation.

Effective date

The provisions of the bill would apply to taxable years beginning after December 31, 1978.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

○